

1977

Italy

Touche Ross International

G. K. Dykes

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business study

italy

Touche Ross International



business study **italy**

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Touche Ross International



Preface

This study is one of a series of Business Studies designed for the use of Touche Ross professional staff in all countries and for interested clients. Users of the study should ascertain whether the information given here has been superseded by later developments. Specific business questions or problems may have legal and tax ramifications that are beyond the scope of this Business Study and the assistance of professional advisers is recommended. Suggestions for revisions should be sent to the Touche Ross International Executive Office.

The amounts quoted in this Business Study are in Italian lire (Lit.). At the time of writing, the approximate Italian lire exchange rates with other currencies were:

| | | |
|-------------|----------------|--------|
| Lit.1,000 = | US \$ | 1.16 |
| | £ Sterling | 0.70 |
| | Deutsche Marks | 2.78 |
| | French Francs | 5.76 |
| | Swiss Francs | 2.98 |
| | Japanese Yen | 342.00 |
| | Dutch Guilders | 2.89 |

Readers should check in the financial press for any subsequent variations in these rates.

December 1977



Introduction

The Touche Ross Business Studies endeavour to provide businessmen considering trade or investment in a country with practical information on business conditions, set against a background of that country's long-term economic structure. They are not concerned with short-term considerations, nor are they commentaries on the current economic scene, other than as necessary to describe regulations in force at the time of writing.

On superficial review, Italy's recent problems of high inflation and unemployment rates and huge balance-of-payments deficits sometimes appear to foreigners to be almost insuperable. A closer look at the period since the end of World War II, however, shows a very different picture. Italy is one of the principal member-states of the European Common Market (EEC) and has developed at a formidable pace over the last 30 years. Some of its present problems derive from its very strength and from the power it has regained as a result of the radical change effected in the country — the conversion of a largely agricultural economy into a major industrial one.

Italy's economic growth is a testimony to the creativity and energy of its people. In the past, Italian culture has had untold influence on Western civilisation, and today, Italian civil engineering and construction techniques and flair for design — to mention but two aspects of the country's industry — are making Italian corporations and their products known throughout the world. 'A man,' said Doctor Johnson, the English man of letters, in 1776, 'who has not been in Italy is always conscious of an inferiority.' Two hundred years later, his view might be paraphrased by saying that a businessman who ignores Italy and the Italians may come to realise that he has missed a great opportunity.

This Business Study was written by G. K. Dykes and J. G. Power of the Touche Ross office in London, England, with the active cooperation of several members of Touche Ross Milan.

Linda S. Avelar
Director of International Publications
December 1977



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THE COUNTRY

Location and Area

Italy is one of the three great peninsulas extending from the European land-mass into the Mediterranean Sea. It is bounded on the north by the great semicircular range of the Alps, which forms its frontiers with France, Switzerland, Austria, and Yugoslavia. To the west of the long boot-shaped peninsula is the island of Sardinia, and to the southwest the island of Sicily. Corsica, to the north of Sardinia, is part of France. In addition to these big islands are several small ones, of which Elba, where Napoleon was exiled in 1814, is perhaps the best known. To the east of Italy is the Adriatic Sea, on the west the Tyrrhenian Sea, and on the south the Ionian Sea; off the country's shorter northern coastline is the Ligurian Sea.

The country has a total area of 301,250 square kilometres (some 116,000 square miles), making it roughly one-half the size of France, three-quarters that of Japan, or somewhat larger than the state of Arizona in the United States. The Italian boot varies in width from 130 to 220 km. (80 to 135 miles) in the middle and southern parts to about 660 km. (370 miles) in the northern section, and it is about 1,200 km. (740 miles) long.

The peninsula contains two independent states: the Republic of San Marino and the Vatican State; while in the north, completely surrounded by Swiss territory, is the tiny Italian enclave of Campione. These three territories are mentioned briefly in Chapter 8.

Natural Features

Upper or continental Italy consists of the great alluvial plain of the country's largest river, the Po, but much of peninsular or Mediterranean Italy and the islands is mountainous. The great arc of the Alps, with some of Europe's highest peaks along Italy's frontiers, is not the barrier that might be imagined, and throughout history trade routes have crossed the great passes between Italy and central and western Europe. Today access roads to France, Austria, and Switzerland are open throughout the year, and there are good tunnel links with France and Switzerland.

Italy in Brief

The Apennine mountain ranges run from north of Genoa down the whole length of the peninsula. They are rugged, but in general not very high; in the south they tend to be relatively barren, making agriculture difficult. On the west of the ranges are several signs of recent volcanic disturbances, and Vesuvius near Naples, Etna on Sicily, and Stromboli in the Tyrrhenian Sea are still active. Earthquake tremors are felt occasionally in a few areas.

The Po is practically the only river used for water transport. Other large rivers in the north are the Adige and the Ticino, while in the peninsula the biggest rivers are the Tiber and the Arno, which flow through Rome and Florence respectively. The beautiful lakes along the southern edge of the Alps are known to visitors from all over the world.

The Regions and Major Cities

Regional characteristics vary widely, and a recognition of regional social and commercial differences is a key to understanding present-day Italy. These differences stem from the Middle Ages, when each large town with its surrounding territory was a tiny state in its own right. Thus a man from the North will not primarily think of himself as an Italian, or even as a Lombard, but as a Milanese, even though he comes from a small village some miles outside that city. The greatest contrast is between the industrial North and the far less developed South, which remains largely agricultural.

The division of the country into regions for political purposes is shown in the map inside the front cover of this study, but the country's most important areas may be summarised as follows:

The Northwest. The great industrial triangle of Milan-Turin-Genoa contains nearly a quarter of Italy's entire population. Milan (*Milano*), with over 2 million people, is the country's commercial and industrial capital; Turin (*Torino*), with 1.2 million people, is a heavy industrial centre well-known as the headquarters of one of the largest automobile producers in Europe; and Genoa (*Genova*), with 850,000, is Italy's biggest port, handling a third of its foreign trade. This area, with its growing population, has a higher standard of living than any other part of the country.

The Northeast. Venice (*Venezia*), with 400,000 people, is primarily a tourist centre of unique beauty, but it is also in the midst of a rich agricultural area in which light industry is growing, especially around its former rivals — Verona and Padua (*Padova*). Trieste, with 300,000 inhabitants is an important port and shipbuilding centre, almost completely surrounded by Yugoslav territory.

Central Italy. The regions of Tuscany, Umbria, Marche, and Lazio have been described as the heart of Italy. They contain the historic cities of Rome (*Roma*), the capital city, with a population of nearly 3 million; Florence (*Firenze*), with 475,000; Pisa, Siena, and others. From this small central area have emerged more geniuses, especially during the Renaissance, than from any other part of Europe, excepting possibly Athenian Greece. Today, apart from tourism and government, agriculture is supplemented by a variety of light industry, and Tuscany has mineral wealth also. Bologna, in neighbouring Emilia, is a large industrial city with a population of 500,000.

The South. South of Rome the country is much less developed, although Naples (*Napoli*), with 1.5 million people, is an important port and industrial centre, as are the cities of Bari (400,000), Brindisi and Taranto. A lower standard of living and higher unemployment in this area have resulted in a drift of population to the North. This drift has been slowed, if not yet reversed, by the government's efforts in encouraging new industry, tourism, and improved farming methods in the underdeveloped South.

The Islands. Sicily and Sardinia, like the south of the mainland, have long been poor and dependent on agriculture. Recently, however, not only are tourism and industry developing, but the mineral wealth of both islands is being actively exploited, and Sicily now has 40% of the country's oil-refining capacity. Sicily's capital is Palermo, with a population of about 600,000, and Sardinia's is Cagliari, about 225,000; Catania is Sicily's second city, with about 450,000.

Climate

The Italian climate can be described as Continental in the North and Mediterranean in the peninsula and islands. In the Alpine North, snow covers the mountains in winter, but summers are warm and pleasant. In the Po valley plain or *Padana*, winters are cold and summers hot, both being characterised by extreme temperatures.

Rain falls throughout the year, but is heavier in the spring and autumn, while snow and fog are common during the winter. Trieste is occasionally hit by a very strong wind called the 'Bora.'

The Mediterranean climate of the peninsula gives it mild winters and long hot summers, mitigated near the coast by ocean breezes. The spring and autumn seasons are the mildest and most enjoyable, with only moderate variation between day and night temperatures.

Italy in Brief

In Rome and the industrial cities of the North, the climate is suitable for business visits throughout the year. The average summer temperature in Rome is around 24° C (75° F).

Natural Resources

Although Italy is generally poor in natural resources, some minerals are produced in significant quantities. Bauxite is the most important, but mercury, sulphur, and zinc are also produced — Italy being the Western world's largest source of mercury. More than 80 grades of marble are produced and large amounts are exported. Limestone and other building stones are abundant, and deposits of asbestos and lead meet most domestic requirements. Sicily has some sulphur deposits. Oil and natural gas (methane) have been discovered in several places (notably in Sicily and the Po valley), but supplies are wholly insufficient for the country's needs. Hydroelectric power is an important natural resource because of limited coal deposits, the rapid depletion of natural gas reserves, and the reliance on foreign sources of petroleum.

The fertile plains of the Po valley and elsewhere are intensely cultivated. Despite Italy's long coastline, its fishing industry falls short of meeting domestic requirements.

The country's scenic grandeur and climate attract thousands of foreign visitors, contributing to a major source of its domestic revenues — tourism.

THE PEOPLE

Population

A census taken in October 1971 showed Italy's population as 54.1 million. The natural increase is under 1% a year and this is reduced by emigration. The estimated population in 1976 was 55.6 million, about the same as that of the United Kingdom, somewhat more than that of France, and less than West Germany's.

Although the average population density is about 185 per square kilometer (480 per square mile), there are big variations between the regions. About 46% of the total population live in the North, especially in Lombardy and Piedmont; 19% in the Centre; and 35% in the South and the islands. Distribution between town and country is in general fairly even; about half the population lives in villages and towns with less than 20,000 inhabitants.

As might be expected, regional characteristics are marked, and although foreigners may not always be aware of the differences, Italians themselves can generally distinguish a southerner from a northerner.

Labour Force

The status of Italy as an emergent industrial power is reflected in the employment distribution of its labour force. In January 1975, this comprised about 35% of the population — slightly more if those available but unemployed are taken into account — distributed as follows:

| | 000 | % |
|----------------------------------|-------------|--------------|
| Agriculture | 2.9 | 15.5 |
| Manufacturing | 6.2 | 32.7 |
| Construction | 1.9 | 9.8 |
| Mining and utilities | 0.3 | 1.7 |
| Commerce | 2.6 | 13.6 |
| Transport and communications | 1.0 | 5.5 |
| Public administration and others | <u>4.0</u> | <u>21.2</u> |
| | <u>18.9</u> | <u>100.0</u> |

The work force is a lower proportion of the total population than in many other European countries; a contributory factor being the comparatively small number of working women. Other points of note are the high percentages of employment in public administration and agriculture compared with other industrialised countries. The proportion engaged in agriculture, however, has been declining for some years and has halved since the end of the 1950s, while in more recent years employment in commerce, transport, and administration has been increasing.

Language

Italian, which is clearly derived from Latin, is the official language and is spoken throughout the country, although some regions have additional languages:

| | | |
|---------------------------------|---|---|
| Valle d'Aosta, in the Northwest | — | French (official) |
| Alto Adige, adjoining Austria | — | German (official) and Ladino (a language, also derived from Latin, spoken in some remote mountain valleys) |
| Trieste, adjoining Yugoslavia | — | Slovene |

Italy in Brief

For historical reasons, a wide variety of dialects and even other languages are spoken, often in preference to the official language. These dialects are used on many occasions and by all classes, although national schooling, improved communications, radio and television, and the influence of military service are slowly reducing the many local variations.

Italians engaged in business often speak other languages, notably English or French, but it is an advantage if a foreign visitor can speak some Italian.

Education

Education is compulsory and free between the ages of six and fourteen; five years are spent at primary school and three at intermediate school. Children who hold an intermediate school certificate may proceed to one of several types of senior secondary school. These senior schools, where courses usually last for five years, may have classical, scientific or technical syllabuses, and success at the final examination qualifies for admission to a university. Other schools give specific vocational, technical or professional training.

There are nearly fifty universities in Italy, some of very early foundation; for example, those at Bologna and Naples date from about the year 1200. Nominal fees are charged for higher education, but even these may be waived for candidates with appropriate qualifications. Unlike many countries, most university examinations are oral. To enter a profession, an additional state examination must usually be taken.

Most schools are run by the state, but some by Catholic religious orders and other organisations. There is no shortage of teachers, but more school buildings are needed. In the south especially there were for a long time few facilities for learning. Reliable literacy statistics are unavailable; estimates range from 80% to 90%, depending on the criteria used, although one source puts the percentage as high as 94% as a result of the special courses in reading and writing that have been instituted in recent years.

Religion

Over 99% of the population is Roman Catholic; the Vatican City State, headquarters of the Roman Catholic Church, is in Italy, but is recognised as an independent sovereign state. The constitution provides equal freedom before the law for all religious faiths.

The influence of the church in Italian life, whether acknowledged or not, is widespread and profound.

History

No visitor to Italy can fail to be impressed by the legacy from its past. Ancient Italy, Greece, and the Middle East were the three sources of Western civilisation, and throughout the ages Italian culture and thought have been preeminent.

Settlers from Greece, Asia Minor, and the Middle East arrived in Italy in the millenium before Christ. Those centred in Rome gradually extended their influence, first over the peninsula and later over the entire Mediterranean world, thus creating the Roman Empire. This dominion attained its peak under the Emperor Trajan (98-117), when it stretched from Britain to the Persian Gulf, and its language, laws, and customs were accepted as standards throughout its vast domains. Even after the fall of the western half in 476, its barbarian successors were overawed by its achievements and attempted to emulate them. The eastern half, or Byzantine Empire, centred on Constantinople, survived until obliterated by the Turks in 1453.

Following the dismantling of the western Empire, Italy was fragmented by invasions of Goths, Lombards, and Byzantines. Later, mainly in Sicily and the South, came Moslems and Normans. The popes, whose supremacy over the Christianised world was early recognised, acquired political control over central Italy on the reestablishment of the Roman Empire under Charlemagne in 800. They retained these territories until 1870, while elsewhere in the peninsula, a mosaic of city-states proliferated. These pockets of power owed nominal allegiance to the emperor and the pope, but often played off one against the other, enduring for the next thousand years with varying degrees of fortune. Some, like Florence, especially under the ruling family of the Medici, became rich and powerful states; others, mainly in the south under Spanish and French monarchies, remained feudal and neglected. The republic of Venice, at the height of its power, was master of northeast Italy, the Adriatic, and parts of the eastern Mediterranean. It was in Italy, and especially in Tuscany, that the Renaissance first flowered, and throughout the centuries Italy continued to inspire Europe with the brilliance of its culture and the grandeur of the Roman Church. Politically, however, the peninsula remained fragmented, and Austria, Spain, and France all exerted power in different areas at different times.

In Italy, as in so much of Europe, the old order was swept away by Napoleon. After his defeat in 1815 a movement was set in motion for the unification of Italy, free from foreign domination. A long struggle ensued and Italy became a kingdom in 1861 under Victor Emmanuel II of Savoy, and in 1870 Rome became its capital. The new monarchy adopted centralising policies, which continued until the end of World War II. Italy became a republic in 1946 and a new constitution was introduced in 1948.

Italy in Brief

Life in Italy

Italian society has had to adapt to major changes in recent years as the country has evolved from a predominantly agricultural to a mainly industrial economy. In the changeover, however, Italians have not simply adjusted to a new mode of life, they have often been prime instigators of those very changes and frequently the leaders in various fields.

Throughout the country there are countless reminders of Italy's heritage — from the Classical through the Renaissance to the Baroque. In towns and cities alike there is little distinction between residential and working districts, so that cities everywhere are alive throughout the day, and each neighbourhood or *quartiere* is like a village full of communal activity within the city of which it is part. Family life is central to all this activity.

In the cities, flats (apartments) are the more usual form of accommodation, although in the country, houses can sometimes be found. Monthly rents for unfurnished apartments in desirable areas range as follows:

| | | Lit. |
|---------------|---|-----------------|
| Rome | — | 500,000-600,000 |
| Milan | — | 400,000-500,000 |
| Smaller towns | — | 250,000-500,000 |

Housing societies provide finance for home purchase, usually up to three-quarters of the cost, repayable over periods up to 30 years. Household appliances, called 'electric servants,' are widely available and purchases can be financed by hire-purchase or they may be paid in installments over various periods.

There are about 200 television sets per 1,000 inhabitants (from statistics of licence-holders), innumerable radio receivers, but only about 20 telephones per 1,000 people. Sports are avidly followed, if not actually engaged in. Italian cuisine is regional and caters to every palate. Several Italian wines are of very high quality.

Every Italian is required to carry an identity card, issued by the local authorities of his place of residence.

Foreigners relocating to Italy for business purposes are exempt from customs duties on their furniture and personal effects and on their automobiles, provided these are at least six months old at the time of importation.

There are international schools in all the major cities catering to the children of the foreign community.

GOVERNMENT AND THE ECONOMY

Executive and Legislative Powers

Italy has been a democratic republic since 1946 when the monarchy was abolished by popular referendum. The fundamental law of the country is now the Constitution adopted on January 1, 1948; it provides for a two-chamber parliament and an independent judiciary.

Legislative power is exercised in Parliament by the Chamber of Deputies, whose 630 members are elected by a modified system of proportional representation for five-year terms, and by the Senate, which consists of 315 elected members, also for five-year terms. Each President of the Republic may appoint five additional members of the Senate for life, and ex-presidents also serve as members for life. Legislation can be initiated in either chamber and must be approved by a majority of both. Emergency legislation can be enacted by decree (*decreto legge*), which has immediate effect, but must be ratified by Parliament within sixty days; failing such ratification, it is retroactively nullified. Either chamber may be dissolved by the President before the expiration of its normal term. All citizens aged 18 or over may cast their votes for members of the Chamber of Deputies and all those over the age of 25 for members of the Senate.

The President is elected by Parliament in joint session for a term of seven years. As Chief of State, his powers include the promulgation of all laws, the calling of general elections, and the supreme command of the armed forces. The President nominates the Prime Minister and, on his advice, the members of the Cabinet. The Prime Minister and his Cabinet constitute the effective executive power and determine general policy which is submitted to Parliament in the form of a legislative programme. The Cabinet is normally composed of members of Parliament and must retain Parliament's confidence. In addition to bills introduced to Parliament by the Cabinet, any 50,000 voters may, by petition, introduce a bill for discussion (500,000 voters for constitutional matters).

In recent years, the establishment of new governments has been extremely difficult, due in part to the multiplicity of political parties with strong ideological bases and limited memberships.

The government ministry for commercial and industrial matters is the Ministero dell' Industria e Commercio, Via Veneto 33, 00100 Rome. For information on new business ventures, however, businessmen are advised to approach the local chamber of commerce or the appropriate employers' industrial association rather than this government department.

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The Legal Structure and the Judiciary

The judiciary is composed of the Constitutional Court (a court which has authority to decide whether legislation is constitutional), the Supreme Court (*Corte Suprema di Cassazione*), and various types of lower courts — magistrate, district and appeal courts. Administrative matters are heard in other courts. From time to time reforms of the legal system are proposed. While the lower courts usually follow the trend of Supreme Court judgments, they are not bound as in some countries by judicial precedent. Tax cases appealed from the Tax Commission (page 142) are handled by the ordinary courts. The courts do not discriminate between Italian nationals and foreigners. Arbitration proceedings may be initiated in many legal conflicts and may be advisable in areas where the courts have a heavy backlog.

New laws and government announcements are published in the Official Gazette (*Gazzetta Ufficiale della Repubblica*). Other matters required by law to be made public appear in either the Legal News Bulletin (*Foglio Annunci Legali*) for unincorporated bodies, or the Official Bulletin of Incorporated Companies (*Bolletino Ufficiale Società Azionarie* or *BUSARL*) for corporate entities.

Regional and Local Governments

Although politically Italy is a centralised republic, it is divided into twenty regions, five of which — Sicily, Sardinia, Valle d'Aosta, Trentino-Alto Adige, and Friuli-Venezia Giulia — were granted a certain amount of autonomy soon after the constitution was adopted. These five regions are governed by regional assemblies, and in 1970 elections for the assemblies of the other fifteen took place as a step in the process of moving some powers from the central to the regional governments. In many cases these regions correspond with the old political groupings before unification, and the granting of powers to regional governments contrasts with the centralising policies of the monarchical period.

The regions are divided into 94 provinces and 8,060 municipalities or communes (*comuni*), varying greatly in size and population. Each commune has a council, headed by a mayor, which is responsible for such matters as housing, roads, and local police. If political deadlock is reached in any of these councils, the central government may sometimes appoint a commissioner to take charge of local affairs.

Advisory and Other Bodies

The National Economic Council (*CNEL*) is an advisory body consisting of representatives of industry and commerce together with independent ex-

perts; its recommendations can be made binding in certain cases. The Council of State mediates between ministries and other public bodies. The Court of Accounts reviews the spending of public money and is thus responsible for seeing that measures taken are in accordance with the laws passed by Parliament.

Political Parties

The main political parties are the Christian Democrats, Socialists, Social Democrats, Republicans, the Social Movement (neo-fascists), and Communists. There are several smaller parties, to the left and the right.

The Christian Democrats are fairly central in the political spectrum, although the party includes a wide range of political views. For many years the largest single party, it has led the government almost continuously since World War II, although since 1963 it has not held a majority and has had to take as coalition partners some of the parties to its left. The formation of a government in these circumstances has often taken several weeks or even months, and differences within the various coalitions have delayed many necessary reforms, such as of the civil service, taxation, health care, and education. Its principal rival is the Communist party, the largest in Western Europe. Following the 1976 elections, the Christian Democrats have had to reconcile their programme to some extent with that of the Communists.

The Communists have stated that they accept an open-market economy and would not increase the already large state sector of industry. They maintain that they would not discriminate against any multinational company that complied with Italian national requirements and produced acceptable financial information. They affirm also their independent stance from all other Communist entities.

The 1975 communal and regional elections resulted in left-wing victories in several places for the first time, and most large towns and cities are now dominated by left-wing parties.

Economic Patterns

Italy's gross national product rose by approximately 6% each year in the 1950s and by almost 5% during the 1960s, reflecting partly the transformation of the country into an industrialised economy but partly also the creative ability of its people in the face of major social and political upheavals. At the same time personal income rose at the expense of industrial savings, resulting in a marked drop in the rate of growth in the early 1970s. A recovery in 1973 was short-lived due mainly to the world oil crisis, in which

Italy in Brief

Italy was particularly vulnerable because of its dependence on imported energy supplies. This factor and the world recession of the mid-seventies have left Italy in economic straits.

Leading industries include mechanical engineering, chemicals, metallurgy, textiles, foodstuffs and tobacco, automobiles, and construction. Many products and services are exported. Two significant features are that manufacturing, although spreading to other areas, remains heavily concentrated in the north, and that industry in general is organised into very small units. Despite the existence of such giants as Fiat (automobiles), Montedison (chemicals, plastics, electrical engineering, etc.) and Olivetti (office equipment), 30% of all industrial establishments employ ten or fewer people. In some industries a single company accounts for 80% or more of total production, the rest being provided by a multiplicity of small firms.

Agricultural production varies widely in kind and quality. Farmland is at a premium and consists of a few large and many small holdings, nearly two-thirds being smaller than 3 hectares (7.5 acres). Several measures have been taken to modernise traditional farming practices, and mechanisation has increased rapidly in the past decade, principally in the north. The major crops are wheat, maize (corn), sugar beet, and fruit, especially grapes; the main agricultural exports are fruits, vegetables and vegetable products, and wines, while the main imports are livestock and livestock products, edible oils and fats, corn, hard wheat, and coffee. In value, Italy's agricultural imports are about twice her exports.

Tourism is a major industry and is Italy's largest single source of foreign exchange. Another major source of foreign currency, until the recession of the mid-seventies that is, was the remittance of emigrant workers' savings.

The country's dependence on foreign supplies for its energy requirements has already been mentioned; domestic production of oil and natural gas (methane) is comparatively small. Oil refining capacity is large and provides substantial reexports of petroleum and allied products. Hydroelectric resources are now fully exploited and a significant nuclear energy programme is planned.

Italy's main trading partners, both for exports and imports, are West Germany, France, the Benelux countries, and the USA. Next in ranking for exports are the UK and Switzerland, while other major sources of imports are Saudi Arabia and Libya. There is increasing dependence on imports of fuel and raw materials, and food imports are about one-quarter of the total. About one-fifth of national production is exported. Italy has benefitted from the formation of the European Common Market, and close to one-half of its foreign trade is now with EEC countries.

Significant statistics are as follows:

| | 1972 | 1973 | 1974 | 1975 | 1976 |
|--|--------|--------|---------|---------|---------|
| Gross national product: current prices (billion lire) | 69,080 | 82,503 | 100,911 | 114,215 | 142,128 |
| Constant (1970) prices (billion lire) | 60,689 | 64,905 | 67,459 | 65,086 | 68,752 |
| Real increase (% per annum) | 3.1 | 6.9 | 3.9 | (3.5) | 5.6 |
| Per head constant (1970) prices (thousand lire) | 1,115 | 1,183 | 1,217 | 1,165 | 1,224 |
| Exports (billion lire) | 10,849 | 12,969 | 19,684 | 22,758 | 30,904 |
| Imports (billion lire) | 11,264 | 16,224 | 26,604 | 25,087 | 36,306 |
| Industrial production (1970 = 100) | 104 | 114 | 120 | 109 | 122 |
| Wages - industrial (1970 = 100) | 122 | 150 | 181 | 188 | 225 |
| Consumer price index (1970 = 100) | 111 | 123 | 146 | 171 | 200 |

Government Participation in the Economy

An important feature of Italy's industrial organisation is the state ownership of many important concerns — about 30% of the country's industry — mainly through three state-owned holding companies: the Industrial Reconstruction Institute (*IRI*), the National Hydrocarbon Agency (*ENI*), and the National Power Authority (*ENEL*). Because of their size and central position in industry, these enterprises enable the government to exert a direct influence on economic trends. Their investments, through about 140 companies, include iron and steel, engineering, automobiles, telecommunications, shipbuilding, air and sea transport, banks, and petroleum and gas industries. Excepting *ENEL*, which has a monopoly of electric power, the other enterprises often compete in the private sector and receive no special privileges.

State-owned enterprises have extended their influence by purchasing equities in private companies, and have on occasion formed joint ventures with foreign investors, although their objectives often differ from those of their private-enterprise partners.



- INVESTMENT INCENTIVES
- FORMALITIES AND PROCEDURES
- SOURCES OF FINANCE
- CONTROLS OVER FOREIGN EXCHANGE

INVESTMENT INCENTIVES

The Investment Climate

Throughout Italy's period of rapid economic growth a marked shortage of capital has persisted. Internal savings do not meet the country's requirements, and so foreign investment is actively encouraged, especially when it involves the creation or improvement of buildings, plant, equipment, or transport facilities and the production of goods or services.

Foreign Investment

Foreign investment has provided a major source of capital, although some commentators have suggested that this has not directly created many new jobs, as it has mostly been by way of acquisitions of existing enterprises. Investment has come mainly from the other EEC countries, the USA, and Switzerland, although much of the Swiss investment may be from Italians reintroducing capital previously converted into Swiss francs. The sectors of industry mostly concerned are commerce and services, chemicals and pharmaceuticals, mechanical engineering, foods, and textiles.

While encouraging investment generally, whether from foreign or domestic sources, the government has sought to channel new enterprises into economically depressed areas, in particular to the south and to the islands. The investment of capital in Italy is regulated by Law 43 of February 7, 1956, which distinguishes between investment in 'productive' and 'non-productive' enterprises as explained later in this chapter.

Some advantages of operating from Italy include its geographical position, favourable for trade with the whole Mediterranean area; its extensive trade relations with Africa, South America, and the Middle East; its good rail and road network; and its adequate supply of labour.

Information on investment in or trade with Italy is available to foreign enquirers from local chambers of commerce. Some firms of lawyers and accountants, especially those used to dealing with foreign businessmen, are also able to supply information. The Istituto Mobiliare Italiano (*IMI*), a

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government-owned medium credit agency, has established an investment information office especially for the benefit of possible foreign investors; its address is Istituto Mobiliare Italiano, Viale Dell'Arte 25, Rome (tel.: 06-54501).

Italy is a signatory to the 1965 'Convention on the Settlement of Investment Disputes' under which an international centre for arbitration and conciliation was set up as a department of the World Bank. The centre is available to help resolve differences concerning investment projects where one party is a government agency and the other a foreign national.

Tangible Investment Incentives

The government's efforts to attract investment have been directed mainly at the economically depressed areas, chiefly in the southern half of the country and the islands (*Mezzogiorno*), and certain small areas in the north. Particularly in the Mezzogiorno, a number of incentives are available, both for new plant and the expansion or conversion of existing facilities. Development programmes to provide essential services, especially in locations known as industrial development areas or centres, have been carried out by the Southern Italy Development Fund (*Cassa per il Mezzogiorno*) in addition to the measures taken to encourage private investment. Additional incentives are granted in Sicily and Sardinia by the regional authorities there.

Southern Italy and the Islands

The Mezzogiorno comprises the following areas, statutorily designated 'assisted territories' (*territori agevolati*):

1. Regions having partial legislative autonomy: Sicily and Sardinia.
2. Nonautonomous regions, all south or east of Rome: Abruzzi, Molise, Campania, Puglia, Basilicata, Calabria, and most of Lazio.
3. Other areas: the Islands of Elba, Giglio, and Capraia, situated off the coast of Tuscany.

The fiscal and financial incentives for qualifying investments are available to Italian and foreign investors, and are regulated by Law 717 of June 26, 1965. The incentive scheme is scheduled to end on December 31, 1980, but most commentators expect it to be extended.

The Government reserves the right to grant incentives according to each project's consistency with the overall objectives of the Mezzogiorno's development programme, which aims at improved utilization of local resources, technological advancement, and higher exports. Priority has been given to projects for the development of local resources and the production of capital goods; to the chemical, engineering, and food industries; to tourist facilities; and to centres for applied research. In general, small and medium-sized enterprises receive higher levels of aid than large ones. The rules are complex and are not detailed here because when this study was being written the new government had announced that it planned, with the approval of the EEC authorities, to publish new proposals for incentive conditions intended to stimulate employment and to encourage diversification of industry. An intending investor should ascertain the current position at the time of his enquiry.

Capital Expenditure Subsidies. The cash grants available from the *Cassa per il Mezzogiorno* vary according to the location and size of the project, the type of additional investment planned, and the nature of the industry. Cash grants are normally given of 30% of the capital expenditure and initial inventory costs incurred, with smaller grants for catering and tourist projects and larger ones for research centres. Expenditure eligible for cash grants includes:

1. Cost of construction and structural components (excluding cost of land).
2. Cost of linking the plant to road and rail networks.
3. Cost of machinery and equipment, including spare parts, and of their assembly, erection, and transportation.

'Cost' includes expenditure under financial leasing contracts. At least 30% of the total initial investment must be provided from the investor's own resources; in practice, because the grants may not be received until about two years after construction commences, the investor may himself have to provide a much higher proportion.

A cash grant is always accompanied by a subsidised loan, but a subsidised loan is sometimes made without a cash grant. A loan is normally subject to the same conditions as a cash grant and is made for up to 70% of the expenditure on plant and machinery (including the cost of land and site preparation) and up to 40% of the cost of inventories purchased.

The loan is normally subject to interest of 7%-9% (lower rates in exceptional circumstances) and is repayable in instalments over fifteen years, when

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allowed for the building of new plant, or over ten years in all other cases. 'Grace periods' before loan repayments must begin are usually allowed, often of two years, subject to negotiation.

Loans are also available to enterprises situated outside the Mezzogiorno, on condition that at least 70% of the proceeds is invested within the Mezzogiorno.

Other Incentives. Among the other facilities granted, the following should be mentioned:

1. Tax concessions. These are described in full in Chapter 8, but may be summarised here as ten-year tax holidays or reductions in certain tax rates, accelerated tax depreciation allowances or tax-free allowances for reinvestment of profits in the Mezzogiorno.
2. Rail freight facilities. Transportation of the following within Italy qualifies for preferential rates:
 - a. machinery and equipment
 - b. raw materials and semifinished products necessary for industrial purposes
 - c. finished products.

The preferential rates apply to state rail transport, from 10% to 50% of normal freight, depending on the distance covered, but only when the cost is borne by an enterprise in the Mezzogiorno.

3. Priority for government supply contracts. Thirty percent of the yearly supplies needed by government departments and public bodies are ordered from industrial enterprises located in the Mezzogiorno.
4. Reduction of electric power costs. Normal charges are reduced by 50% for power used by industrial facilities in the Mezzogiorno.
5. Reduction of labour costs. Social security charges are usually reduced by 8.5% for employers and 1.5% for employees. In addition, grants are made towards the cost of labour retraining.
6. Free facilities. Land, road and rail connections, and utilities may be provided free in some districts by groups of communes (*comprensori*).

Additional Assistance in Sicily and Sardinia. In addition to the incentives offered by the national government for the south and the islands, the regional governments of Sicily and Sardinia may provide additional assis-

tance. This takes various forms, such as provision of publicly owned land rent-free, or additional grants towards the cost of land; differing rates of grants or loans; provision of equity capital and financing of inventories. Assistance is granted at the discretion of the regional government concerned.

Central and Northern Italy

There are some localities in central and northern Italy which are also designated as assisted territories because they are still underdeveloped, notwithstanding that this part of the country is in general industrially more advanced than the south. Some assisted territories are in mountainous country and are difficult to reach, but other areas are near large industrial centres and have suffered only from the tendency of businesses to choose locations in large towns.

Business entities in localities designated as assisted territories may thus be eligible for benefits. The assisted territories are generally in Lombardy, Piedmont, Liguria, Veneto, and Emilia-Romagna.

In these areas small and medium-sized enterprises may obtain loan financing at reduced rates from medium-term credit institutions for the construction or expansion of manufacturing plant and the provision of inventories, sometimes for up to fifteen years. Loans cannot exceed Lit.1 billion.

Enterprises in the catering and tourist industry may also obtain finance at reduced rates, from credit institutions operating in this field, for the construction and enlargement of hotel buildings and other tourist facilities. Grants are available in a few cases also. Incentives in this industry vary from region to region.

Interest rates and the duration of loans are fixed by a decree of the Ministry of the Treasury; financial incentives outside the Mezzogiorno are based on Law 614 of July 22, 1966.

Further benefits are available from the regional governments of Trentino-Alto Adige, Valle d'Aosta and Friuli-Venezia Giulia (including Trieste). These benefits vary widely, and information about them can be obtained from the chambers of commerce in the areas concerned.

Tax incentives are also given as described in Chapter 8. They consist of accelerated depreciation allowances and ten-year holidays from local taxes in certain circumstances.

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Applying for Incentives

The principal benefits in the Mezzogiorno area by way of cash grants and loans at concessionary rates are made available through the Institute for the Economic Development of Southern Italy (*ISVEIMER*).

Another specialist institution, the Regional Institute for the Financing of Industry in Sicily (*IRFIS*) deals with investment in Sicily; and Sardinian Industrial Credit (*CIS*) with investment in Sardinia. Addresses of these institutions are:

| | | |
|----------|---|---|
| ISVEIMER | — | Via S. Giacomo 19, Naples (tel.: 081-321.707) |
| IRFIS | — | Via G. Bonanno 47, Palermo (tel.: 091-266.200) |
| CIS | — | Corso Vittorio Emanuele 68, Cagliari (tel.: 070-668.484) |

The Cassa per il Mezzogiorno is situated at Piazza dei Kennedy 20, Rome (tel.: 06-59911).

Incentives are also available through other regional financial institutions and from IMI and Mediobanca (described later in this chapter). Information and advice on investment in the Mezzogiorno is provided by a government agency, IASM, whose address is Viale Pilsudski 124, 00197 Rome (tel.: 06-805.241), and others.

No particular legal formalities have to be followed for the granting of incentive finance. The credit institutions concerned request the documentation necessary in each case.

Restrictions on Investment

Capital introduced to Italy may be invested freely in any sector of the economy with a few exceptions, including shipping, aviation, newspapers, insurance, and banking, for which special regulations apply. For example, ships flying the Italian flag must be owned by corporations registered and controlled in Italy, and aircraft registered in Italy must be owned by Italian citizens or corporations at least 60% Italian-owned. Foreign life assurance companies must be represented by Italian resident citizens.

The extent of state participation in the economy has been indicated in Chapter 1. Post and telecommunications, rail, electricity, and (at present) tobacco are state or municipal monopolies or near-monopolies. The principal airlines are state-owned, but some private companies provide internal flights. Government supply contracts are awarded only to Italian citizens or

to corporations whose directors are Italian citizens, although in certain cases this restriction does not apply to the other EEC countries. Residence can be substituted for citizenship in cases where Italy has reciprocal agreements on this point.

As in other countries, some trades require special licences for public health or similar reasons or to ensure that adequate qualifications are held, for example, by professional practitioners.

Traders who import or export goods subject to licensing procedures must register with the Ministry of Foreign Trade, and all retailers (including suppliers of food and drink, and mail order and vending machine operators) must be specially licensed by the municipal or sometimes the regional authorities.

While businesses may be set up anywhere in the country, permits for industrial development will be issued only in areas designated for that purpose.

FORMALITIES AND PROCEDURES

Rules Applicable to New Businesses

All new businesses must comply with various registration rules. Foreign-owned businesses must in addition comply with the Foreign Investment Law of 1956, which deals with exchange controls and the raising of loan capital in Italy, as described later in this chapter.

Register of Enterprises. In theory, every new business entity must be registered in the Register of Enterprises (*Registro delle Imprese*). The original plans for setting up this register, formulated in 1942, have never been implemented, but an equivalent record is kept at the court (*cancelleria del tribunale*) of the district in which the new entity's official address is located. For simplicity, this record is referred to in this business study as the Register of Enterprises. In practice, however, only incorporated enterprises follow this rule. Information in these registers may be inspected by creditors or other interested persons. Agency agreements should also be registered. The information to be filed in the register varies with the type of enterprise — corporation or branch (or, in theory but not in practice, partnership) — but broadly includes:

1. A copy of the constitution documents of the enterprise, showing its name, purpose, and official address or legal seat.

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2. The amount of subscribed and paid-in share capital.
3. The name, address, nationality, and other personal particulars of each supervising and managing director or branch manager.
4. The authority of each manager or managing director to represent and bind the enterprise in dealings with third parties, and if there are two or more such officers, whether one may act alone or only in combination with another. Copies of authorised signatures must also be deposited in the register.

Every change in the information filed must be reported to the court and entered in the register.

Chambers of Commerce. In addition to registration at the court, all enterprises must register with the local Chamber of Commerce, Industry, and Agriculture, a quasi-government body that can provide considerable information and help to new businesses. A foreign enterprise seeking to register (for example, in respect to its proposed Italian branch) must act by a power of attorney notarised by an Italian consul or equivalent in its own country. Partnerships, sole traders, and agents, as well as incorporated bodies, must register. The chamber of commerce allocates a registration number to each corporate body or branch registering with it.

Other Rules. All new enterprises must notify their local income and VAT tax offices and social security organisations that they have commenced business. Some activities require special licences — for example, retail trades, insurance, and dangerous processes as already described.

Status of Foreign-Owned Businesses

In principle there is no discrimination between companies owned by Italian citizens and those owned by foreigners, and with few exceptions, as already indicated, an Italian company can be entirely foreign-owned and managed if so desired. The requirements for information to be filed differ between Italian-registered companies and branches of foreign companies in Italy, as described in Chapter 6, but in most cases both forms may trade equally and both may freely appear before the courts.

Any company having its principal business in Italy is regarded as an Italian company even if it is incorporated elsewhere. Foreigners can acquire land in almost all areas equally with Italian nationals. Apart from the need to comply with exchange control regulations (discussed later in this chapter) and personal permits (discussed in Chapter 4), there are no special rules that a foreign-owned business must follow.

Checklist for Investors

Because some business practices in Italy differ from those in other countries, a foreign investor must enquire about the customs and procedures of any proposed associates in such areas as:

1. Books and records kept. For tax evasion and other reasons it has been the practice of some concerns to keep two or more sets of books, but the rights of any purchaser would be based for exchange or other purposes only on the 'official' books.
2. Past tax practices and attitude towards arrears.
3. Extent of undisclosed assets and any restrictions on shareholders' rights thereto.
4. Bonus and compensation practices and whether there is any difference between declared and actual pay.
5. Relationships with government officials and others.

Whether a new entity is to be created, an existing business purchased, or a licencing agreement or joint venture entered into, professional advice and firsthand knowledge of any prospective partner are essential.

SOURCES OF FINANCE

Historically, a major source of finance for industry and commerce in Italy has been retained earnings, although in recent years levels of self-financing have fallen as high wage costs have reduced corporate profits. Fixed-interest borrowings, in the form of bank finance and bond issues, have always been very important, and the specialist loan institutions, often with government backing, play a big part in providing finance for industry and commerce. By contrast, insurance companies, pension funds, and the stock exchanges (at least as far as equity capital is concerned) are not nearly such important sources of finance as they are in some countries.

Financial and Credit Institutions

These include the banks, the specialist institutes, and the stock exchanges. The country's banking structure is derived from the Banking Law of 1936.

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The Central Bank. The powers of the central bank (*Banca d'Italia*) are derived from a government interministerial committee for credit and savings, presided over by the Treasury minister, which decides national monetary policy. The central bank (which rather surprisingly is owned by the savings and other banks and not by the state) is the executive arm of this committee and supervises the whole banking system; it approves the establishment of new banks, fixes reserves and ratios, determines interest rates, and acts as a lender to other banks.

Banking Institutions. A major proportion of Italy's credit system is state controlled, although the banks and other institutions concerned have considerable operational autonomy within the credit guidelines and controls exercised by the central bank. The 1936 Banking Law clearly separated the functions of commercial and investment banking, so that short-term credit is handled by the commercial banks and medium- and long-term credit generally by special credit institutions. In practice, because short-term finance often consists of revolving overdraft facilities, the commercial banks are frequently involved in longer-term support.

There are four main groups of banks. Those of prime interest to foreign readers are the commercial banks in groups 1 to 3.

1. Banks of national interest (which means that they serve the whole country) are owned primarily by IRI. They mainly serve commerce and industry and handle most foreign exchange transactions through foreign branches, correspondents, and consortia. They are the Banca Commerciale Italiana, Banco di Roma, and Credito Italiano. They hold about 25% of total bank deposits but are more important in the foreign banking field than this percentage would suggest.
2. Banks of public law or chartered banks, which are owned by the state, directly or indirectly. They include the Banco di Napoli, Banco di Sicilia, Banca Nazionale del Lavoro (Italy's largest bank), Istituto Bancario San Paolo di Torino, and Monte dei Paschi di Siena. These banks are the only commercial ones authorised to lend to public bodies and municipalities and to grant medium- and long-term credit to industry and commerce.
3. Privately owned banks, which offer all the usual commercial short-term banking services. There are about 160 of these banks, and the deposits with them are larger than those of either of the two groups already described. They tend, however, to operate only regionally or locally, although some — such as Banca Nazionale Dell' Agricoltura, Istituto Bancario Italiano, Banco Ambrosiano, and Banca d'America e d'Italia — are quite large and have branches throughout the country. Cooperative

banks are very similar except for their ownership structure; there are over 200 of them, some with many branches, and they are identifiable by the inclusion of the word *Popolare* in their names.

4. Savings banks (*Casse di Risparmio*), pledge banks, and rural and artisan banks. The savings banks have many branches and very large deposits. They exist mainly to serve private individuals and small businesses but are not limited in the services they offer; some of the bigger ones compete directly with the commercial banks. The Cassa Di Risparmio Delle Provincie Lombarde is the largest of its kind in the world. The post office also acts as a savings bank. The pledge banks are a distinctively Italian feature and make small loans against the security of personal possessions as well as acting as savings banks.

Several foreign banks have branches in Italy, and others have representative offices in the country, usually in Milan and Rome. Banks from all around the world have connections with the commercial banks, especially the 'banks of national interest.'

Special Credit Institutes. Nearly 50 organisations specialise in the provision of medium- and long-term finance. They themselves are financed principally by savings and commercial banks, insurance companies, government bodies, and the public through bond issues on the stock exchange. Most are at least partly state owned, directly or indirectly.

The most important is the state-owned Istituto Mobiliare Italiano (*IMI*), which operates nationally and grants approximately one-third of all medium- and long-term industrial credit. There are also three regional institutes which are financed by the Cassa per il Mezzogiorno; these are ISVEIMER, IRFIS, and CIS, already described. Mediocredito Centrale is a state-owned institute that provides funds for many other regional or specialist medium- and long-term credit bodies.

In addition to these bodies directly owned by the state, there are several private sector investment banks. The three largest are Mediobanca, owned by the 'banks of national interest' and listed on the Milan stock exchange; Efibanca, owned by a group of large commercial banks and industrial companies; and Centrobanca, owned by the cooperative banks. The chartered banks may also grant medium- and long-term credit. Several other institutes in this category specialise in finance for specific industries, such as agriculture, catering, and construction.

The post office offers current (checking) account facilities which are widely used, but there is no separate giro transfer system as found in several other European countries.

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Types of Bank and Special Institute Finance

Short-term credit, defined as credit for 18 months or less, is provided by the commercial banks. It is regulated by an interbank agreement which fixes upper and lower limits for interest rates, individual overdraft rates being renegotiated at least annually. A variety of instruments is used — for example, discounted commercial paper, advances, contangoes (that is, the financing of future contracts), and in particular overdrafts. Repeated renewal of overdrafts is an accepted practice, although sometimes risky. Fixed loans are not usual. The banks often require a high degree of security, and this sometimes makes it difficult for smaller enterprises to borrow from them. Italian subsidiaries of foreign companies frequently obtain bank finance on the security of guarantees provided by their parent companies.

Medium- and long-term credit provided primarily by the special credit institutes and investment banks usually consists of loans, generally for 5 to 15 years (20 years in exceptional cases). These loans are usually secured by first mortgages on real estate, although collateral in the form of plant, securities, or guarantees is not unusual. Interest rates may be relatively low because of various state subsidies.

Credit granted by the special credit institutes is an important and growing source of finance for commerce and industry, because the institutes can float bond issues on terms more favourable than individual corporations and because few corporations raise share capital on the stock exchanges. Smaller enterprises, as well as larger ones, can obtain loans from the special institutes, although long-term finance is not easy to raise.

Restrictions on Borrowing by Foreign-Owned Enterprises. Any enterprise formed in Italy with foreign capital may raise finance in Italy, but certain restrictions apply as detailed later in this chapter. The general rule is that if share capital is foreign owned, loan finance should come partly from foreign sources also. This general rule does not apply to short-term borrowings, nor to enterprises classed as 'nonproductive' as defined later in this chapter.

Share Capital

The banks are forbidden by the 1936 Banking Law to hold equity shares unless specially authorised. Foreign-owned enterprises usually look to their parent companies for equity capital and would not normally attempt to issue shares to outsiders, either privately or through a stock exchange. Small and medium-sized enterprises usually raise share capital privately from family members or friends. A state-owned financing company, *GEPI*, is sometimes

able to help enterprises in danger of closing down for lack of adequate equity capital by taking up shares, and *IMI* may also take up shares to finance research projects, development programmes, and tourist facilities.

The issue of share capital in excess of Lit.500 million requires Treasury permission, and so does any issue of loan capital in excess of that figure.

The Stock Exchanges

There are stock exchanges in ten cities, but only those at Milan (by far the most active), Rome, and Turin are of any significance.

Trading activity on the Italian exchanges is limited. Investors number in the hundreds of thousands, compared to millions in other European capital markets. About 160 shares are quoted on the Milan exchange, and most trading is confined to a limited number within this group. Very few foreign securities are presently listed, although they are not barred. The overwhelming majority of stock exchange transactions is in state and local bonds and in the bonds of the special credit institutes already described. The bulk of finance raised on the stock exchanges for industry and commerce is thus channelled through these bonds.

Stockbrokers and their representatives (maximum of two per stockbroker) are the only persons allowed to work on the trading floors of the stock exchanges. They enjoy the status of civil servants and handle all trading, but as the banks, with whom many orders are placed, are permitted to offset buying and selling instructions they receive, many transactions do not take place through the exchanges. There is a secondary market (*mercato ristretto*) outside the official exchanges, where again dealings in bonds far outweigh dealings in shares, although this market is not legally recognised.

Among the factors that make share issues on the stock exchanges unpopular are their relatively high cost to the companies concerned compared with bond issues, the risks involved to investors in equity investment compared with bonds or bank deposits, and the difficulty of evading tax on dividends. There are indications, however, that attitudes are changing.

Requirements for Listing. An application to list the shares or bonds of an Italian company requires approval by the Treasury, the Chamber of Commerce, the Stock Exchange Committee, the Governing Body of Stockbrokers and, in due course, by the National Commission (*CONSOB*) described later in Chapters 6 and 7. Other preliminary conditions to be fulfilled are:

1. The applicant must be a legally constituted company with a paid-in capital of at least Lit.500 million.

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2. The legally adopted and published financial statements for the two preceding years must show the company has made a profit.
3. A dividend must have been paid for at least the previous year.
4. The shares to be listed must be fully paid, freely transferable, and entitled to dividends without restriction. Separate application must be made for each class of shares.
5. Evidence must be provided that the shares are owned by a sufficient number of shareholders to make a proper market. In estimating whether there is sufficient investor interest to permit stock exchange listing, the Stock Exchange Committee may take into account any trading in the secondary markets.
6. An examination of the financial accounts must have been made by an authorised auditing firm (this rule is not yet in force — see Chapter 7).
7. Other information and documents (such as constitution documents and specimen scrip) must be supplied to the appropriate Chamber of Commerce; modified rules apply to subsequent issues.

Foreign companies wishing to list securities must provide similar information and documentation and must also demonstrate:

1. That the security concerned is listed on a stock exchange in its home country.
2. That financial statements for the two preceding years, prepared in accordance with the laws of its home country, have been published in Italy in the Official Gazette and in other newspapers designated by the Chamber of Commerce of the city in which the stock exchange is located.
3. That an agent is available in that city to handle the securities.

Before a new issue of shares can be made, a prospectus must be published giving general information about the company, the terms of the issue, the promoters' interest, and other background matter. Promoters are entitled to not more than 10% of the profits of the company making the issue for not more than five years.

Other Sources of Finance

In addition to the commercial and other banks subject to supervision by the Banca d'Italia there are several finance houses (*finanziarie*). These do not

take deposits from the public and so are not subject to the Banking Law, and are therefore able to provide both short- and long-term credit to industry and commerce.

Factoring and leasing facilities are available in Italy, if not yet as widespread as in other European countries.

Personal finance is relatively easy to obtain from the commercial banks and the pledge banks already described and other specialist bodies also provide private credit.

Export finance is available for up to five years by discounting an exporter's bills, often at favourable rates, through such government special credit institutes as Mediocredito Centrale.

Large and well-known Italian corporations may be able to raise finance in the Eurocurrency or Eurobond Markets; the Italian credit institutes themselves obtain funds from these markets and lend them on to domestic borrowers. Italy has been a major beneficiary of aid from the EEC's Social and Regional Funds, but this aid is generally channelled through public bodies rather than directly to individual enterprises.

Banking Customs and Payments Procedures

Italian banks have a high reputation and offer a full range of services in both domestic and foreign business. Many settlements between buyers and sellers are still made in cash, but payment by cheque is becoming common practice in northern Italy. In the south, cheques offered in payment are accepted only when the debtor is known to the creditor. Banks do not return paid cheques to their customers.

Credit cards are used to a limited extent. Bank cards are accepted as evidence that the issuing bank will honour cheques drawn on it by the holder of the card. Eurocheques (cheques drawn on banks in other European countries) may be cashed in Italy on presentation of the holder's cheque book and bank card.

Banks generally provide statements of account to their customers quarterly if they are in credit or monthly if overdrawn but will produce them more frequently (for a small fee) on request.

Small charges are made for operating current (checking) accounts, but interest is allowed on such accounts when in credit. This interest is allowed not at nominal rates as in most other European countries but at commercial rates varying from bank to bank, often at present at 12% or more.

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An important banking practice in Italy is the maintenance of a 'risk exchange,' through which banks may obtain information on the borrowing position of their customers. Since many enterprises use several banks, this enables a prospective lender to decide whether the borrower is a good risk or not.

CONTROLS OVER FOREIGN EXCHANGE

Currency

Italy's monetary unit is the lira (plural, lire), abbreviated as 'Lit.,' a contraction of 'lire Italiane,' or sometimes '₣' (not to be confused with the similar symbol for the pound sterling, which is worth about 1,400 lire). Denominations in circulation are:

Notes — 500, 1,000, 2,000, 5,000, 10,000, 20,000, 50,000, and 100,000 lire.

Coins — 5, 10, 20, 50, and 100 lire. Silver 500 lire coins are seen occasionally.

There is a shortage of small coins. Packets of sweets, tram tickets, or telephone tokens were often used in place of small change until the public began to protest, and the leading banks now issue large quantities of their own guaranteed 'mini-cheques,' in amounts of 50, 100, 150, and 200 lire.

Exchange Markets and Practices

Because of Italy's economic difficulties in recent years the lira has not fared very well in relation to other currencies. It is not one of the currencies in the joint European arrangement known as the 'snake-in-tunnel,' whereby member countries allow narrower fluctuations between their currencies (the 'snake') than provided for in the 1971 Smithsonian Agreement on exchange rates (the 'tunnel'). A two-tier exchange system was introduced in 1973 whereby capital account transactions (in 'financial lire') took place at different rates from current account transactions (in 'commercial lire'), but this was discontinued in 1974 when the lira was allowed to float. 'Float' is something of a euphemism, for the fall in value of the lira between the end of 1972 and the end of 1975 was 34% in terms of French francs, 43% in West German marks, 16% in Japanese yen, 68% in Swiss francs, and 17% in US dollars. In terms of pounds sterling, however, the lira fell only 1% during this period.

Exchange regulations are issued by the Foreign Exchange Office (*Cambital*) on the basis of instructions from the Ministry of Foreign Trade. Foreign exchange transactions are governed by the Banca d'Italia, although in practice the commercial banks handle them as its agents. All foreign exchange transactions must be made known to *Cambital* by the bank or other institution involved within sixty days. Daily exchange rates are fixed by *Cambital* and are published in the financial press in Milan and elsewhere.

EEC rules for the free movement of capital have been deferred for the time being with the consent of the EEC Commission.

Controls on Inward Investments

Italian exchange controls do not restrict investment in Italy by foreigners in any way, although some limitations are placed on borrowing. The main exchange regulations concern the repatriation of capital and income. These regulations are, however, subject to administrative changes which can be made speedily in order to stop speculation against the lira, and advice should be sought whenever a transaction involving foreign currency is contemplated. Investment may be in the form of cash or machinery.

Capital Accounts. In order that foreign currency investments may be identified and controlled, the proceeds of all currency imports by foreign investors are placed in special capital accounts (*conti capitali*) operated by authorised banks, and all subsequent transactions concerning such currency must pass through these accounts. Although on some occasions in the past transfers abroad could be made from capital accounts with little restriction, at present, because of pressure on the lira, the rules concerning productive and nonproductive investments described in the following paragraphs are strictly applied.

Productive and Nonproductive Investments. Under the 1956 Foreign Investment Law, investments are classified as productive or nonproductive, and different regulations apply to each class. The major benefit of classification as a productive investment is that branch profits, dividends, and capital may be freely repatriated without limitation as to amount or time.

Productive investments are defined as investments of foreign capital designed to commence or expand the production of goods or services, requiring the acquisition of capital equipment to be used for an extended period. Productive investments may include the construction of buildings, roads, and power transmission lines, the reclamation or improvement of land, the drilling of wells and tunnels, and the use of ships or aircraft. Other invest-

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ments may also be interpreted by the Treasury as productive, especially if they result in creating employment. Productive enterprises must obtain the permission of the Treasury to buy shares in other enterprises, Italian or foreign. It is not relevant whether a productive investment results in the establishment of a new company with entirely foreign capital, a new company with a mixture of Italian and foreign capital, or an increase in capital by way of participation in an existing Italian company. If unquoted shares are to be purchased by a foreign investor, the price to be paid may be subject to a share valuation by a stock exchange committee.

To obtain approval of an investment as 'productive,' the prospective investor must apply to the Treasury, either directly or through a bank, giving full details of the proposed operation. The Treasury has 30 days in which to issue a provisional ruling. If the provisional ruling is favourable, another application, this time for a definitive certificate, must be made to the Treasury when the investment project is completed. The Treasury must issue the definitive certificate within 90 days. Some investors prefer not to apply for a definitive ruling until the benefits of unlimited repatriation are desired.

Nonproductive investments are portfolio investments and any others not officially approved as productive. Holders of such investments are entitled to remit interest, dividends, or profits net of taxes up to an annual maximum of 8% of the capital invested. Capital itself may not be repatriated until after two years from the date of the investment and only up to the amount of the foreign currency originally invested. Any excess of income or capital would be subject to exchange control restrictions in force at the time. The 8% limit does not apply however to investments from other OECD countries.

Either productive or nonproductive investments may consist of imported machinery. In such cases, the same transfer rules apply as when foreign currency is invested except that no transfers may be made for the first two years.

Whenever Italian resident enterprises or individuals sell shares to foreigners or nonresident Italians, they must report such sales to *Cambital* within 60 days. Purchasers in such cases should ensure that the sellers have complied with this rule.

Borrowings by Foreign-Owned Enterprises. Medium- and long-term borrowings in Italy (including bonds) made by productive enterprises are restricted because the Italian authorities not unnaturally expect foreign-owned enterprises to provide finance from abroad. All such borrowings must be

made known to the Treasury at the time they are made. The restrictions are:

1. If the enterprise is wholly foreign owned and has no share capital participation by Italian nationals residing in Italy, or if it is a branch of a foreign firm, its borrowings in Italy may not exceed 50% of the capital introduced into Italy.
2. If the enterprise has some Italian participation but foreigners own more than 30% of the share capital, borrowings in Italy may exceed 50% of the total capital (that is, share capital and reserves), but only if the excess is matched by similar loans from foreign sources in the same proportion as foreign equity to total equity.
For example, if an enterprise has share capital and reserves of 100 million lire, of which foreigners own 50%, and wishes to raise medium- or long-term loans of 70 million lire, it must show that it has raised 50% of 20 million lire (that is 70 million less 50% of 100 million), or 10 million lire, abroad.
3. If foreigners own less than 30% of share capital, local borrowings are not restricted.

Failure to comply with these restrictions would result in the loss of the enterprise's productive investment status and thus the freedom to repatriate capital and profit without limitation.

Foreign-owned enterprises that are classified as nonproductive have only restricted repatriation rights but in return may freely borrow in Italy.

Borrowings of capital account lire, although subject to Treasury authorisation, are not subject to the 50% limit as they are not considered local borrowings. Furthermore, there are no restrictions on short-term borrowings.

Borrowings from abroad require prior authorisation, which is given after consideration of the facts of each case. The authorisation will provide for repatriation of principal (usually after three years) and interest.

Borrowings by Italian-Owned Enterprises. Italian resident individual citizens and businesses cannot accept loans from nonresidents without prior licence from the Treasury. The minimum periods within which repayment can be made and the maximum rates of interests permitted change frequently, so that the current rules must be ascertained from a bank when a loan is contemplated.

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Relaxation of the Borrowings Rules. The limits imposed on long-term borrowings by foreign-owned enterprises from their parent companies in OECD countries, on short- and medium-term borrowings by foreign or Italian-owned enterprises up to Lit. 250 million from within the EEC area, are more liberal than those for other types of borrowing. There are certain other relaxations also.

Repatriation Provisions

The rules concerning repatriation of capital, dividends, branch profits, loan amortisation, and loan interest have been mentioned already in the description of productive and nonproductive investments. Shares or bonds purchased in Italy by a foreign investor that are subsequently transferred to another foreigner or to an Italian national resident abroad retain any benefits accorded by law to the original purchaser. Transfer of shares in productive enterprises must be reported to the Treasury, through the Italian bank that handles the transaction, within 15 days.

Any transfer abroad of any amount resulting from a foreign investment is normally subject to the condition that all direct taxes due have been paid. The transferor must obtain a certificate from the provincial revenue office where he is domiciled as proof of payment of direct taxes due, and produce it to the bank which is effecting the transfer or directly to *Cambital*. Such a currency transfer may take place before the taxes are paid if a guarantee acceptable to the local revenue office is produced by the transferor. When the transfer involves dividends or other income on which taxes were deducted at source, the revenue office will issue a certificate showing that no further tax is due.

Licences and royalty agreements may be freely entered into, and although transfers abroad of royalties, fees, and service charges are subject to exchange control regulations, these generally pose no difficulties if the amounts are reasonable and adequately documented. The Italian Patent Office must have confirmed the validity of any patent concerned. Prior authorisation from the Ministry of Foreign Trade is required for royalties exceeding Lit.5 million per year payable to most countries in the Communist bloc.

Other normal commercial transactions supported by documentary evidence may be settled freely within the time limits described below. These limits are changed periodically by the government.

Imports and Exports

Foreign currency is freely available for all imports for which proper documents, including any required licences, are produced. Imports must usually

be at least 90% paid for within 360 days after customs clearance. If the importer wishes to make advance payments against imports, he can only do so up to 30 days before customs clearance. In dealings with other EEC countries, the deadline may be extended for five years, subject to certain formalities.

In its endeavours to reduce Italy's huge balance-of-payments deficits, the government has from time to time introduced import deposit schemes with the agreement of the EEC Commission. In 1974, for example, importers were required to lodge deposits of 50% of the value of the imports concerned for six months interest free in the Banca d'Italia before customs clearance could be obtained. In 1976 this scheme was reintroduced for all imports except wheat, but the period of the deposit was three months. To help meet the import deposit requirements in 1974, exporters in other EEC countries were permitted to make loans up to Lit.250 million to individual Italian importers without any special authorisation.

Export sale proceeds must be collected within 360 days before or 120 days after customs clearance, with exceptions in the case of EEC countries, and the foreign currency sold to the recipient's bank. Any lire deposits must be cleared within one month. Departures from the rules about payment periods require approval from *Cambital*.

Debits and credits in current accounts must be settled separately and may not be offset.

Foreign Nationals' Funds

There are no restrictions on the transfer of earnings by foreign employees in Italy, provided that it is proved that the earnings have been obtained legally.

Nonresident foreigners may operate lire accounts (called *conto lire estere*) largely free from restriction. However, as soon as a foreigner becomes resident, he is subject to the same regulations as an Italian national. Nonresidents can freely operate Italian bank accounts in foreign currencies.

Controls on Outward Investment

Italian investments in or loans to foreign countries must be reported to and approved by the Ministry of Foreign Trade, and an additional 50% of the amount to be invested must be deposited with the Banca d'Italia in a noninterest-bearing account. Italian residents cannot hold accounts with foreign-domiciled banks and must obtain ministerial permission for foreign

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real estate investments. Investments in foreign securities may be made freely, although *Cambital* subjects them to close control. Investments in most mutual funds require approval of the Ministry of Foreign Trade.

All foreign receipts or payments by residents must be documented and, in some cases, must be reported to the Treasury. Receipts of foreign currency must either be transferred to *Cambital* through an authorised bank or deposited in an authorised foreign currency account which can only be used for making payments abroad within six months. In particular, there is a very strict limit on the amount of foreign currency that a resident may obtain for nonbusiness purposes.

Despite these restrictions, a large amount of capital is thought to have been exported illegally over the years, and in 1976 an amnesty was announced in order to allow Italian residents to repatriate illegal foreign assets without penalty. Repatriation of at least 15% of each such asset had to be made by February 19, 1977.

Exchange Controls of Foreign Investors' Own Countries

A foreign investor must consider the exchange controls of his own country as well as those of Italy. Although the Italian rules may allow currency transfers in given cases, the authorities in his own country may take a different view.



- FOREIGN TRADE
- MARKETING PRACTICES
- PATENTS, TRADEMARKS, AND COPYRIGHTS
- GENERAL REGULATION OF BUSINESS

FOREIGN TRADE

Foreign trade has become increasingly more important to Italy as it has become an industrialised country and the standard of living of its people has risen. Like most of the other member countries, Italy has benefitted from membership in the Common Market, European Economic Community (EEC), which has proved a great stimulus to both industry and agriculture.

Imports as well as exports have grown, and in recent years economic difficulties have resulted in some restrictions on imports as already described. These restrictions have been imposed within the EEC rules requiring freedom of trade throughout the Common Market, and on each occasion when they have been introduced, they have been regarded as merely temporary. A recovery of world trade from the recession of the mid-seventies should make Italy a rewarding outlet once again for those who make the necessary effort to understand and cater to the Italian market.

The preceding chapter has mostly assumed that a manufacturing or distributing operation is to be set up in Italy; this chapter discusses questions of trading with Italy and the associated subjects of marketing, protection of industrial property, and other business regulations. Labour questions are described in Chapter 4, and the mechanics of operating a subsidiary or branch, in Chapter 6.

Licences and Controls

Except for certain products from Japan and the Communist countries and other particular cases, goods may be imported without an import licence. Licences are required for a small group of imports — chiefly agricultural items. Certain other products are on an automatic licensing system, which means that licences are granted on request. Licences are normally valid for six months, but this period can be extended.

There are several regulations concerning the marking and labelling of merchandise, notably foodstuffs, pharmaceuticals, textiles, cosmetics, and products containing toxic substances. Further regulations deal with safety of machinery and equipment and other technical requirements and with health

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for live animals, food products, plants, and the like. Shippers to Italy should consult their agents or customers in Italy to ensure that these rules are complied with appropriately.

Licences for exports from Italy are required in only a few cases, such as armaments, precious stones, antiques, and works of art.

Customs Duties

Italy and the other member countries of the EEC have adopted a common external tariff (CET). This allows free movement of all industrial goods and most agricultural products within the EEC, provided the goods concerned either originated in the EEC area or were subject to the CET on first import into that area. The late joiners, Denmark, Ireland, and the United Kingdom, mainly completed the adjustment to EEC rules by July 1, 1977.

The 'Customs Cooperation Council Nomenclature' (formerly 'Brussels Nomenclature') is used to classify merchandise. Most raw materials enter duty-free or at a rate seldom in excess of 3% (ad valorem). Rates for semifinished goods range from 2% to 15% and for finished products from 4% to 24%. Illustrations of specific rates are: commercial vehicles, 22%; organic chemicals, up to 19%; plastics, 8-18%; and diesel engines, 12%. The CET is still being reduced in successive stages as a result of the Kennedy Round of tariff negotiations. Almost all Italian duties are ad valorem although a few specific duties remain. Ad valorem duties are levied on a 'normal' price, which includes all costs, charges, and expenses incidental to the sale and delivery to the place of entry in Italy. Normal price is the open market price on the day of the customs declaration in an arm's-length transaction. It does not include duties and taxes levied within Italy. Purchase price may be used instead of normal price, if it is higher than the normal price. Usually the customs authorities do not automatically accept the price charged by a parent to its Italian subsidiary for duty calculation purposes, and in certain cases they even take the subsidiary's selling price as the basis for customs duty calculation, on the grounds that this is the first independent sale in the country.

Materials to be used in manufacturing a product for subsequent export may be imported by a 'temporary import' system. Under this system, duties and taxes need not be paid if, instead, the importer provides an acceptable guarantee for the amount due, this guarantee being released when the finished product is exported. The law also provides for refund of duties paid on raw materials and semifinished products used in the manufacture of certain exported items (mainly products of the mechanical industries). Refunds are obtained by application to the Finance Ministry.

Italy is a member of the International Convention to Facilitate the Importation of Commercial Samples and Advertising Matter. Samples may be admitted free if they comply with prescribed conditions, mainly to ensure that they have no commercial value. Printed advertising matter is dutiable on entry, but catalogues, price lists, and trade notices may be admitted free if the name of the manufacturer or seller is prominently shown, if only one copy of each document is included in each package, and if the weight of each package is not in excess of 1 kilogramme (2.2 pounds). Alternatively, commercial samples or goods for exhibition may be imported on provision of returnable deposits or guarantees, either to the Italian customs authorities or to an approved body (e.g., a chamber of commerce) in the exporting country, by use of an international customs clearance document known as an ATA Carnet. A salesman may find it useful to obtain a certificate from a chamber of commerce in his home country confirming his position as a salesman or commercial traveller, stating his address, nationality, and the enterprise he represents, and briefly describing the samples he carries with him.

Simplified customs procedures also apply to goods carried in vehicles approved under the International Road Transport Convention and accompanied by TIR Carnets. Heavy vehicles may require special permits to enter Italy.

In Valle d'Aosta, Campione d'Italia (discussed in Chapter 8), and elsewhere along the Swiss frontier, customs duty rates are reduced on some products — for example, tobacco and alcohol — to residents as well as visitors. Petrol (gasoline) is cheaper than in the rest of Italy to residents of Valle d'Aosta.

The EEC countries' population is over 250 million. The nine EEC countries have negotiated preferential trade agreements with Greece, Spain, and Turkey, with the EFTA countries (Austria, Finland, Iceland, Norway, Portugal, Sweden, and Switzerland), with several Mediterranean states, and, under the 'Lomé Agreement,' with 46 developing African, Caribbean, and Pacific (ACP) territories. Exports from Italy can thus reach a very large market duty-free or on preferential terms, while imports also come on similar terms from EEC and associated countries. This is an important factor in any decision to set up a manufacturing unit in Italy. Greece, Portugal, and Spain have applied for full EEC membership, and it is possible that Turkey may be admitted at some future date.

There are no duties on exports. Italy has concluded trade agreements with many countries (a function now taken over by the EEC), and its exports generally enjoy 'most favoured nation' import duty rates in other countries.

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Since customs duties may be of prime importance to foreign enterprises, and as regulations are complex, it is recommended that professional assistance be secured or local inspectors of customs duties be contacted at an early stage, especially by those outside the EEC arrangements.

Other Duties and Taxes

All imports into Italy, whether from EEC countries or not, are liable to value added tax (*Imposta sul Valore Aggiunto*, or IVA) at the same rates as those imposed on domestic goods, which vary between 6% and 35% according to the nature of the goods. Exports are not subject to value added tax. This tax is described further in Chapter 8.

Certain agricultural products are subject to compensatory levies or premiums instead of or in addition to import duties, in accordance with the EEC's common agricultural policy.

Other taxes are levied on the production of alcohol, petroleum and mineral oils, cigarette lighters, and a few other products.

Documentation

In addition to the normal documentation (commercial invoices in duplicate, bills of lading, etc.) used in international trading, a special bank document called a 'bank approval' (*benestare bancario*) is required for payments over Lit.1 million so that the Italian Foreign Exchange Office (*Cambital*) can check that currency settlement is effected within the due time.

For duty-free trade between Italy and other EEC countries, 'EEC free circulation certificates' are required. These must be prepared by the exporter concerned and must be sanctioned by his local customs authorities. Certificates are issued for goods originating in Italy, which for this purpose includes products which have undergone processing in that country. The definition of 'processing' is complex, but, broadly, products must have undergone a complete change or have increased in value by at least 50% as a result of being processed. These certificates are also issued for goods originating outside the EEC for which EEC customs formalities have been completed and CET duties and levies have been paid.

Certificates of origin are required for a few products, for example, coffee, liquids, gases, and fish products, and for imports from Hong Kong, Macao, and Singapore. Certificates of origin may also be required at any time if customs officials have any doubt as to origin. Special forms are needed for

imports from EFTA countries, the 46 ACP countries, Spain, and elsewhere, to ensure that preferential customs duty concessions are obtained. These forms are issued in the exporting countries concerned, normally by chambers of commerce on production of evidence produced by the exporter.

It is usual to employ a customs broker in Italy to ensure that imports are properly cleared through customs. Unless goods are claimed within 15 days of arrival they are placed by the customs authorities in storage, where they incur rentals and fines; if not claimed within three months they may be treated as abandoned, and confiscated. Once goods are claimed, however, they need not be cleared immediately and can be left in storage for up to four years.

Free Ports and Transit Arrangements

Trieste is Italy's only 'free trade zone.' As this zone is considered outside Italian customs jurisdiction, goods may be landed, stored, processed industrially and reshipped, all without becoming subject to import duties. Customs-free depots exist at all commercial ports where goods may be stored, unpacked, and repacked, but no processing may take place. The main ports with such facilities are Genoa, Venice, Naples, and Leghorn (*Livorno*).

MARKETING PRACTICES

Advertising and Promotion

Expenditure on advertising tends to be low compared with other EEC countries. Press advertising is the most widely used medium for sales promotion. Newspapers in general have only small circulations, except the few that cover the whole country. More important as advertising media are the popular weekly magazines, of which there are several with circulations over or around one million.

There are two national commercial television channels and three national commercial radio stations, all reaching most of the population, although their advertising time is limited. In addition, there are several local private television and radio programmes, all carrying advertisements. More important are three foreign television channels aimed at the Italian market, which reach about 60% of the population. Films (movies) and direct mail shots are other advertising media. A particularly Italian feature is the widespread use of posters and billboards not only in towns but along major roads throughout

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the country. Sites for billboards are let out to concessionaires who cover the whole country, but boards are difficult to control and are subject to various local restrictions.

Gift schemes are widely used as a means of sales promotion, especially for foodstuffs and other commodities in everyday use, but their operation is strictly controlled by law.

Italy has many advertising agencies including several with international connections. Because advertising facilities — for example, on the private television and radio programmes — may change at short notice, a foreign enterprise is well advised to consult an established agency before planning a campaign.

A number of trade fairs are held annually or biennially, and they are widely attended and influential. The most important is the Milan Trade Fair, held every April. Most of the other fairs are more specialised, but important ones are held in Turin, Rome, Naples, and Bari as well as Milan.

Selling and Distribution Methods

The Italian market is a competitive one, and foreign suppliers usually find it essential to have some sort of representation in the country. Most suppliers at first appoint an agent or distributor in Italy and later consider setting up their own distributing organisation or manufacturing establishment.

Because of the density of population and high living standards in the Milan-Turin-Genoa triangle, where consumer demand is very important, most agents are based in the north, and the few that can in practice offer good national coverage are not easy to find.

Representation in Rome is essential for suppliers wishing to sell to the state-controlled enterprises that are responsible for a growing share of the country's development. Many of these enterprises have their head offices in the capital; in particular, the headquarters of the *Cassa per il Mezzogiorno* is in Rome. Hence separate agents in Rome, Naples, and a northern city are often appointed, with another agent or subagent in Sicily.

Agency law in Italy is based on the provisions of the Civil Code and on a series of national economic agreements given the force of law by presidential decrees in 1960-61. The position of the agent is strong: agency contracts for indefinite periods may be terminated only after proper notice has been given, and the agent is entitled to indemnity unless he was himself to blame for the termination. Notice periods are usually for at least three

months or such other period as laid down in the contract, but indemnities can vary widely as the courts take into account many different circumstances, such as the expenses incurred by the agent, the loss of commission the agent would suffer, and the benefits that the principal has obtained through the agent's efforts. An agency contract for a specific period is allowed and expires at the end of the stated period; no notice need be given by either party.

It is always advisable for legal advice to be taken before agency agreements are entered into, particularly from the point of view of liabilities to tax and social security contributions. Trading through an agent may in some circumstances make the foreign supplier liable to Italian taxation as described in Chapter 8, whereas trading through a distributor will not, as the distributor will purchase as a principal, hold inventories, and carry all risks. Neither agents nor distributors are 'employees' for social security purposes in normal circumstances. The appointment of agents or distributors would not normally contravene EEC law against agreements that are likely to prevent, restrict, or distort competition within the Common Market, but businessmen must have regard to this law, which is summarised later in this chapter.

Foreign export agents who process enquiries for Italian importers are not popular, and government agencies in particular prefer to deal with enterprises in Italy, whether in the form of agents, branches, or subsidiaries of the foreign suppliers. All Italian buyers prefer their suppliers to deal with import documents and customs clearance formalities.

Retail distribution in Italy is fragmented, with many thousands of small family-run businesses, and the proportion of retail sales made through multiple stores, department stores, and supermarkets is very small when compared with countries in Northern Europe or North America. The number of bigger retail outlets, large wholesalers, and cooperative buying associations is slowly growing, but the problems of agents in dealing with many small customers will remain for some time.

Personal contacts with customers and agents are always beneficial. Other matters to which suppliers to the Italian market should pay particular attention are adherence to promised delivery dates, prompt supply of spares or replacements, and prompt replies to business letters.

Franchising has been adopted in the food and drink and cosmetics industries, but is not widely used.

As an alternative to the use of an agent or a distributor, a foreign supplier may decide to use his own salesmen. The formalities to be observed if

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foreigners are so employed are described in Chapter 4. Some suppliers then establish a stockholding point in the country to facilitate distribution there or in neighbouring areas. Others set up a fully staffed branch or subsidiary company to distribute or manufacture in Italy. (The customs duty implications of such actions and registration requirements are indicated earlier in this chapter. Tax implications are described in Chapter 8, and formation procedures for Italian subsidiaries and branches, in Chapter 6.) Other methods of trading with, as opposed to in, Italy include licensing and reciprocal trading agreements.

Correspondence should be in Italian whenever possible, and trade literature must always be, any translations being checked and corrected in Italy. Metric measurements and European continental sizes should always be given. Prices should be quoted in lire CIF an Italian port or border to facilitate customs calculations, and it is always useful to state the appropriate CCC Nomenclature customs class.

Trade Credit Conditions

There are no fixed trade terms, and these vary from one supplier to another. Generally, however, goods should be paid for within 60 to 90 days of the invoice date, without interest. Only for specific categories of business is an extension, in exceptional circumstances, granted.

Bills and sight drafts are frequently used, but foreign accounts are normally settled by letters of credit. Accounts receivable are usually covered by bills which may be discounted at the bank. The factoring of debts is a growing practice.

Credit information on customers can be obtained from banks and a number of investigation agencies, and the registers of enterprises and chambers of commerce can supply background and historical information on most businesses. The collection of overdue debts involves long and expensive court processes, as there are few specialist debt collecting agencies in Italy. Credit insurance can be arranged, but this is not a common practice as premium rates tend to be very high.

PATENTS, TRADEMARKS, AND COPYRIGHTS

Patents

Italy is a signatory to the Paris Union Convention for the Protection of Industrial Property. Consequently, a patent application submitted in any

signatory country (most of the industrialised countries of the world) establishes a one-year priority in Italy. This means that a foreign inventor has one year from his application for a patent (*brevetto*) in his own country in which to take out a patent in Italy, even though during that year someone else in Italy may have tried to establish a patent for the same invention.

An application for a patent may be filed by an individual or a corporation. Products, processes, techniques, and shapes and designs of products may all be patented, except pharmaceutical products and processes.

Patent applications may be made to the Central Patent Office in Rome or to an appropriate provincial office. They must be accompanied by specifications and drawings and a fee based on the number of pages in the application (for example Lit.31,000 for ten pages). This fee covers the first three years of the patent's life. Patents are valid for fifteen years from the date of application provided annual fees are paid ranging from Lit.8,000 in the fourth year to Lit.150,000 in the fifteenth year.

No novelty or merit examinations are made, and patents are presumed valid until a court of law declares otherwise. The burden of nullifying a patent rests with the challenger, and in this connection the expense and time involved in litigation in Italy should be remembered.

Patents may be modified or added to, assigned, transferred, or licensed. An inactive or insufficiently utilized patent may become subject to compulsory licensing, normally three years after being granted. A complex procedure determines the compensation payable to the patent holder in such a case. The patent lapses if the invention still remains unused, or the renewal fees are not paid, or an earlier application for the same invention is granted.

Modified rules apply to patents for industrial designs; specifically, they are granted for only four years.

An employee who invents a new product has the right to be recognised as its inventor, but unless the invention has no connection with his employment, his employer is entitled to any benefits arising from it. The employer would have to compensate his employee for these benefits unless the employee's duty was specifically to make inventions, for example, if he was employed in a research laboratory.

Patent laws are sufficiently complex to require the services of a patent agent in this field, but general enquiries can be directed to the Central Patent Office (*Ufficio Centrale Brevetti per Invenzioni, Modelli e Marchi*,

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Ministero dell'Industria e Commercio), via Molise 19, Rome. Italy is a signatory to the European and EEC Patent Conventions whereby single registrations become effective in all the countries concerned.

Trademarks

A trademark (*marchio*) may be registered in Italy on application to the Central Patent Office or a provincial office. As in the case of patents, a specialist agent in this field is usually engaged. There are no opposition rules, and the first applicant is entitled to registration, although a prior user who can prove his claim can have the first application cancelled unless five years have passed since registration. The priority period for foreigners under the Paris Convention for a trademark application is six months. The initial filing fee is Lit.5,000, and when registration is effected, a further fee of Lit.20,000 is payable. Registration is for twenty years, renewable for similar periods for a fee of Lit.20,000 per period.

Registration is not compulsory, and an unregistered trademark can be legally defended, especially if widely known. There are no examination provisions, other than generally to see that there is no confusion with an existing mark and that no false impressions are given. Services as well as goods can be the subject of a trademark.

Once registered, a trademark may only be forfeited if it becomes the accepted name for another commodity and the holder has made no attempt to stop infringement. A trademark will lapse if it is not used within three years of registration or if its use is discontinued for three years.

International applications for registration of trademarks are governed by the provisions of the Madrid Agreement of 1891, to which most Continental European countries and one or two countries in the Mediterranean area are parties. Registration of a trademark by a national of any one of the member states of the agreement in his own country automatically provides registration in all the others. A national of any other country who establishes a presence in Italy can register his trademark with the International Bureau for the Protection of Industrial Property in Geneva on the basis of a national registration in Italy.

Copyrights

Copyrights may be obtained for literary works, music, art, plays, and moving pictures. Copyright protection is granted for the life of the originator plus 50 years, in accordance with the Universal Copyright Convention, or for 30

years from first screening of a film. Copyright works should show the name of the author or originator, date of first publication, and the letter 'C' in a circle.

GENERAL REGULATION OF BUSINESS

The Civil Code

As is usual in most continental European countries, the basic law is set out in a series of codes designed to present civil, commercial, and criminal laws in systematic and comprehensive form. In Italy, civil and commercial law is embodied in the Civil Code of 1942. The code covers such matters as the rights of individuals and families, rules for inheritance of property, property rights and obligations such as guarantees and mortgages, labour law, and regulations concerning the various business entities described in Chapter 6.

Fair Trade Laws

Fair trade is regulated by the Civil Code. Briefly, the following acts are regarded as constituting unfair competition:

1. Using names or distinctive signs likely to create confusion with others or closely imitating the products of competitors.
2. Attempting to discredit the products or activities of a competitor.
3. Disregarding the principles of correct business behaviour or acting in any way likely to injure another.

Cartels (*sindacati*) among enterprises engaged in the same trade or industry are regulated by the Civil Code. The cartel contract must be in writing, or it is not valid. Cartels must have limited duration and definite objectives.

The EEC authorities are currently preparing several draft laws concerned with consumer protection, such as product liability rules, advertising standards, and packaging and labelling requirements.

EEC rules prohibit the restraint of trade between member states of the Common Market by the distortion of competition and enable cross-frontier monopolies to be challenged; these rules are summarised on the next few pages.

Price Controls

These are administered by the Interministerial Price Committee and cover some thirty goods and services such as petroleum, sugar, cement, coal,

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fertilizers, and pharmaceuticals. Because price levels are often determined by political rather than economic considerations, they are sometimes unrealistic.

Emergency programmes to slow inflation have been imposed from time to time. These have included price freezes on sales by manufacturers to retailers, as well as retail price controls.

Mergers

There are no specific rules or restrictions regarding mergers or business concentrations. The assets brought into a merger are subject to registration taxes at lower rates than those applicable to normal transactions.

If one or both of the companies merging are listed on a stock exchange, each listed company must furnish to the National Commission for Corporations and the Stock Exchange (*CONSOB*) an explanatory report on the proposed merger.

EEC Legislation on Fair Competition

Articles 85 and 86 of the Treaty of Rome, which established the European Common Market, concern restrictions on competition and are of considerable importance to manufacturing and trading organisations; they are therefore described here in some detail. Another rule relating to this subject is contained in Article 36.

One object of the EEC is to establish a single market within which all organisations can offer their goods or services to all consumers without restrictions of any kind. The most obvious restrictions that originally existed were national customs duties, which have now largely been abolished. Other restrictions slowly being tackled include discriminatory import procedures, bars on the free movement of service, state monopolies, state aids to industry, and differences in legislation. These are matters that are dealt with at government level; Articles 85 and 86 set out to prevent individual business enterprises from creating further barriers. In principle, any acts upsetting the economic conditions of the EEC are prohibited, unless the effect is insignificant or is advantageous from an economic or competitive point of view. Examples of prohibited practices are price fixing, market sharing, production restrictions, or discriminatory terms of supply.

Article 85 is concerned with agreements and concerted practices between undertakings and Article 86 with the abuse of dominant positions. They

apply whenever there is a possibility that consumers in one area may be treated differently from those in other areas, but they do not bar cooperation where this will favour competition. It should be noted that the rules govern not only intra-EEC agreements but also agreements by enterprises in the EEC with bodies in other countries if they affect trade within the EEC. There are heavy penalties for noncompliance.

In Article 85 paragraph 1 prohibits 'all agreements between undertakings, decisions, and concerted practices, which may affect trade between member states and which have as their object or effect the restriction of competition within the Common Market.' 'Agreements' are legally enforceable contracts, but 'concerted practices' could be operated on a much less formal basis. Paragraph 2 states that 'any agreements or decisions prohibited by this article shall be automatically void,' although they are not void in practice while the possibility exists of obtaining exemption. Once an agreement has been notified to the EEC Commission, exemption may be granted in accordance with rules set out in paragraph 3 of the Article.

It is essential that enterprises themselves should apply for exemption. A request for a 'negative clearance' should be made to the Commission accompanied by a request for 'exemption' under paragraph 3. Once an agreement has been notified it is provisionally valid until the Commission makes its decision. Application must be made to the Commission in Brussels on Form AB in ten copies. Negative clearance will be granted if the Commission is satisfied that there are no grounds under Article 85(1) for them to take action. If however the facts suggest that action may be required, the Commission will consider the possibility of granting an exemption. Questions of law may be taken to the European Court in Luxembourg.

Matters taken into account when deciding whether an agreement (for example, an exclusive sales agreement) limits competition include:

1. The position and importance of the parties and the nature of the product.
2. Whether the agreement is isolated or one of a series.
3. The severity of the conditions and whether some absolute territorial protection is given, or conversely, whether parallel trading or re-export are allowed.
4. The benefits to be obtained from cooperation between enterprises, such as improved production or distribution, or technical or economic progress.

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An agreement between a parent company and its subsidiary would not be prohibited as the latter is not an independent enterprise.

There are numerous exemptions from the provisions of Article 85, and these are indicated in the table on page 54. This table is only a summary of the exemptions, and it is important to obtain legal advice when agreements are being drawn up. In addition to the various broad classes shown in the table, many individual agreements have been exempted from the requirements of Article 85 following notification. These rules have now been in operation for some years; they appear complex, but are directed towards fair competition throughout the Common Market.

Article 86 prohibits abuses by any enterprise of a dominant position within the EEC that may affect trade between member states. For the article to apply, the enterprise must be able to prevent effective competition within an important part of the relevant market, for example, by the creation of a cross-frontier monopoly.

Article 36, in the section of the Treaty of Rome dealing with the elimination of quantitative restrictions, provides that industrial and commercial property rights may not be exercised so as to restrict trade — for example, a patent licence must not enable the licensee to prevent imports from another member state or to use different pricing policies in different member countries.

Insurance Practices

The many insurance companies that exist in Italy (including many large international companies) provide cover against most business risks. Insurance services are regulated by Law 449 of 1959 and subsequent variations and by the Civil Code.

There are different rules for life insurance and indemnity (damage) insurance. Those companies, Italian or foreign, which intend to provide life insurance must obtain special permission from the Minister of Commerce and Industry; the minimum capital requirement is Lit.500 million, half of which must be paid in. A foreign company must prove that it has carried out life insurance activities for at least ten years, and permission will not be granted unless Italian companies are given reciprocal rights in the foreign country concerned.

Companies providing indemnity insurance also require permission from the Minister, but capital requirements are lower (for example, Lit.250 million for fire, and Lit.150 million for personal injury).

Normally a basic insurance contract is entered into, but additional risks may be added through appendices. The contract will be renewed automatically unless notice to the contrary is given within a stated period. Third-party insurance for motor vehicles is compulsory.

Life insurance companies are obliged to reinsure part of their risks (40% during the first ten years of activity) with the National Insurance Institute (*INA*); this reinsured portion is guaranteed by the state.

Export credit insurance against political risks and natural disasters (but not financial or currency risks) is available from *INA*.

Environmental and Health Considerations

The safety and health of workers in industry are governed by various laws. Insurance against industrial accidents must be provided as described in Chapter 4.

Specific rules against pollution principally relate to the safeguarding of water and air. In the past these rules have not always been fully respected, but because of some widely publicised disasters in 1976, it is likely that controls will be enforced more strictly in the future. Installations causing pollution must be approved by the local authorities before they commence operations and must be equipped with appropriate control equipment such as filters.

In some parts of the country health and social services are still being improved. The housing shortage is acute in places, and in some over-crowded cities sewage disposal is sometimes a problem.

Information Required on Business Documents

All letters, invoices, and documents issued by a corporate body must state its name, legal address, amounts of capital subscribed and paid in, and registration number.

Information to be shown on invoices for value added tax purposes is described in Chapter 8.

Real Estate

Most sites have adequate utilities and are served by road and rail connections. The South is gradually becoming more accessible.

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Evidence of the ownership of land and buildings and the existence of any mortgages are recorded in the Property Roll (*Conservatoria dei Registri Immobiliari*) kept at the local court. The title to land and buildings is transferred by means of a contract subscribed before a public notary.

The price stated in the contract may possibly be lower than the real price, to minimise taxes. Verifying title to real estate in these circumstances causes problems. Since the tax reforms of 1974, this practice is likely to become much less prevalent, because not only are the tax authorities empowered to charge tax on market values, regardless of the figure on the contract, but also the penalties for attempting to evade tax by understating a transfer price are now heavy.

Long-term leases whereby capital sums are payable on commencement for the right to occupy real estate for a stated number of years (called 'contract of usufruct') are recognised but are very unusual. Long-term rental agreements are quite common as in most other countries.

The constitution of the Republic guarantees property rights and provides that if private property is expropriated because of some public requirement, fair compensation must be paid. Although the rights to stone or minerals dug from the surface of the land remain (with some exceptions) with the owner of the land, the rights to mined minerals belong to the state, and concessions to prospect for or work them must be obtained from the Ministry of Industry and Commerce. Certain rights are reserved to the National Hydrocarbons Institute (*ENI*).

Permits for all building activities are required from local authorities and, in most cases, from the central government also. The granting of a permit can take considerable time, and in general time and money may be saved by purchasing or leasing an existing building. Land can often be obtained at a low price or even free from communes in depressed areas. Legislation on industrial building construction is designed to preserve present amenities and control land speculation.

Commercial and industrial premises are generally fairly easily available. Rentals vary widely between the depressed areas and the large northern cities. In Milan, annual rental of typical warehouse accommodation is at present around Lit.10-12,000 per square metre (about ten square feet). Office accommodation can usually be found without difficulty, at rents ranging in Milan or Rome from Lit.20,000 per square metre per year for small suites to Lit.65,000 or more for prestige air-conditioned accommodation.

International Trade Organisation Membership

As a major trading nation, Italy has joined all the international organisations that promote liberalization of trade — for example, the General Agreement on Tariffs and Trade (GATT), the Organisation for Economic Cooperation and Development (OECD), and the International Monetary Fund (IMF).

The importance to Italy of European Economic Community membership has already been indicated, and the Italians have always been strong supporters of the EEC, founded in 1958, and its associated bodies. The EEC is much more than merely a customs union. The founding Treaty of Rome calls for the free movement of goods, peoples, services, and capital; for common agricultural and transport policies; for the approximation of the relevant laws of member states; for the establishment of regional aid and social funds; and for measures to coordinate commercial and economic policies. The six original members — Belgium, France, Germany, Italy, Luxembourg, and the Netherlands — were joined on January 1, 1973, by Denmark, Ireland, and the United Kingdom. The EEC's population of over 250 million constitutes one of the world's most important markets for raw materials, industrial equipment, and consumer goods.

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Summary of agreements, decisions, and concerted practices not invalidated by Article 85 of the Treaty of Rome affecting all the countries of the European Common Market

| Agreements which need not be reported | Agreements outside the scope of Article 85 | Exempt agreements |
|--|---|---|
| <p>These are described in Regulation 17 of 1962 amended by Regulation 2822 of 1971.</p> <ol style="list-style-type: none"> Those where the parties are all from one member state of the EEC and the terms do not relate to trade with other member states. Those where only two parties are involved and the agreements are limited to: <ol style="list-style-type: none"> the fixing of selling prices to third parties restrictions on the rights of users of patents, 'know-how,' and the like to the application of industrial processes. Those which have as their sole object: <ol style="list-style-type: none"> the development of standards joint research and development specialisation in manufacture, where not more than 15% of the trade in the relevant product in a substantial part of the Common Market is concerned and where the combined annual turnover of the parties does not exceed 200 million UA.* | <p>These are agreements not restricting competition or which, if restrictive, are immaterial.</p> <ol style="list-style-type: none"> Official Journal of 1962, December 24th. Those agreements which, even if exclusive, are between a principal and a commercial agent whereby the agent merely negotiates on behalf of a particular supplier (in his own name or otherwise) without assuming financial responsibility for the goods concerned. Official Journal of 1970, June 2nd. Those agreements not affecting more than 5% of trade in the relevant products in the Common Market area concerned, and where the parties have combined annual turnover of not more than 15 million UA* (industrial enterprises) or 20 million UA* (other bodies). Official Journal of 1968, July 29th. Cooperation agreements whose sole object is, for example: <ol style="list-style-type: none"> exchange of technical or market information joint activities such as advertising, debt collecting or accounting shared production, storage or transport facilities shared execution of orders, or shared after-sales service, where the parties are not themselves in competition. | <p>These include individual exemptions under Article 85(3) and those covered by 'block exemptions' already granted as follows:</p> <ol style="list-style-type: none"> Regulation 2779 of 1972. Those agreements for specialisation of production where not more than 10% of trade in the relevant products in any member state is concerned and where the combined annual turnover of the parties does not exceed 150 million UA.* Regulation 67 of 1967 amended by Regulation 2591 of 1972. Those agreements between not more than two parties in which: <ol style="list-style-type: none"> one undertakes to supply the other exclusively with certain products for resale in certain areas or one undertakes to buy only from the other for the purpose of resale both purchase and sale arrangements as above are dealt with. (Note: A supplier cannot forbid a distributor to sell to a customer in another area who comes to him with an order.) The Commission has been authorised to grant block exemptions for patent, licence and related agreements but has not yet issued regulations. |
| <p>*Note: 'UA' or 'Units of Account', in the context of the EEC's competition rules only, are equivalent to about Lit. 625.</p> | | |



- THE LABOUR FORCE
- POSITION OF FOREIGN NATIONALS
- TERMS AND CONDITIONS OF EMPLOYMENT

- FRINGE BENEFITS AND SOCIAL SECURITY
- LABOUR - MANAGEMENT RELATIONS

THE LABOUR FORCE

Availability

The Italian labour force is estimated at 19 million people. Traditionally, Italy has been a labour-surplus country, but rapid industrialisation has led to a shortage of skilled workers. The country's development since World War II has caused a steady movement of labour from the underdeveloped South to the more prosperous North and from the country to the cities.

Unemployment averaged around 3.5% for several years before the world recession of the mid-seventies, although this average masks the higher figures in the South. As a result of the recession and the return of some emigrant workers from abroad, the level has risen, although meaningful figures are difficult to obtain as many unemployed are not registered as 'seeking work' and the effect of underemployment is difficult to judge. On the other hand, many workers have part-time jobs in addition to their main occupations. Unemployment has, however, become recognised as a structural feature of the economy, and with the exception of those areas with tourist facilities, the *Mezzogiorno* provides one of Western Europe's biggest labour reserves.

Women constitute only about one-fourth of the labour force, a lower proportion than in many countries. While officially there is no discrimination between men and women, socially the idea of 'career women' is a new concept, although it is rapidly entering the business scene. Many women also work with their husbands in shops or small businesses or in lower-paid city jobs.

Standards of training, like attitudes to education, vary, but in general are improving. Some large employers give time off or refund tuition fees paid by workers willing and able to improve their skills.

Employees are classified into three main groups — executive managers (*dirigenti*), staff employees (*impiegati*), and workmen (*operai*). This classification is important as it affects conditions of employment, fringe benefits, and social security contributions.

Labour Conditions

Recruitment

Private employment agencies are not permitted in Italy. While employers may in some cases hire labour directly, the normal procedure is to use the government employment service, which provides workers through a series of local labour exchanges (*Uffici di Collocamento*), operated by the Ministry of Labour and Social Security.

Normally an employer must accept a worker sent to him from the labour exchange, except where particular skills are involved or where the worker has been previously discharged by the employer, as for instance for indiscipline. Workers who have been made redundant have priority in allocation to new jobs. All except quite small enterprises must reserve a proportion of available jobs for disabled or otherwise disadvantaged workers.

Unlike manual workers or staff employees, executive managers may be recruited freely, for instance through personal contacts or newspaper advertisements. Although in theory it is not lawful to recruit other employees by these means, newspapers are widely used to advertise for technical, clerical, and even manual workers. Some private consultants specialise in personnel selection.

POSITION OF FOREIGN NATIONALS

Generally speaking, it is fairly easy for an employer to hire a foreigner provided there is a specific need for his services, which means that the employer must prove that no Italians with comparable qualifications are available. In addition, reciprocity must exist between Italy and the foreigner's home state, as in the case of the EEC countries. Foreigners with technical or managerial skills, or particular knowledge of a foreign parent company's procedures and requirements, should have no difficulty in complying with the necessary regulations.

Documents and Procedures

Neither visas to enter Italy nor authorisations for short visits are required by citizens of the other EEC countries, the United States, and most other developed countries. Foreigners contemplating permanent employment in Italy, however (with the exception of nationals of EEC countries who are regarded as equals in every respect to Italian workers), must observe certain regulations.

The required procedure for a foreign national from a country outside the EEC who already has a residence permit for Italy is fairly simple. He applies

for a work permit to the foreigners' office (*Ufficio Stranieri*) of the police headquarters (*Questura*) where he lives. The application must be accompanied by a letter from his prospective employer and a certificate from the local Ministry of Labour Office stating that the position sought cannot be filled adequately by an Italian citizen. The permit is issued by the Ministry of Internal Affairs after consultation with the Ministry of Labour and Social Security; it is valid for one year, but may be renewed.

The procedure is more complex when the foreign national is not yet living in Italy. He must make his application through an Italian consulate in his home country before he leaves for Italy, and he must make arrangements to obtain the following documents:

1. Work permit granted by the Ministry of Internal Affairs. An application, accompanied by a letter from his prospective employer, must be made to the provincial labour office. A work permit is issued only for a specific job with a specific employer, and if the employee wishes to change his job he must apply for a further permit.
2. Visa issued by the *Questura* to the Italian consulate of the employee's country of origin. This is issued on presentation of the work permit to the *Questura*.
3. Entry visa, entitling the foreign worker to enter Italy. This is issued by the Italian consulate upon application by the employee.
4. Residence permit (or permission to stay in Italy). This is issued by the *Questura* to the foreign employee on arrival in Italy. Again, application must first be made to the Italian consulate concerned. It is valid for one year and is renewable upon presentation of an authorisation by the provincial labour office for the employment concerned.

This procedure can take up to three or four months, but may be shortened if the prospective employer applies to the local labour board and police, who then send the permit to the Italian consulate abroad.

Employers must inform the labour office without delay whenever a foreign employee is engaged or dismissed.

Although a national of any other EEC country is free to enter Italy and take work there, he must obtain a modified residence permit from the *Questura*. This is granted on request for 5 years and is renewable.

Foreigners working in Italy for less than a month and paid by an employer in another country — for example, technical salesmen or installation staff servicing a customer in Italy — do not need any permits.

Labour Conditions

Labour Law and Social Security

In principle, foreign nationals receive the same treatment as Italian citizens, except that they are not permitted to register with the labour exchanges for job placement. The Italian social security system covers all employees working in Italy and their dependents living there. By special arrangement, nationals of other EEC countries and of some other countries receive social insurance benefits similar to those available in their home countries.

In some cases outside the EEC area, social security contributions may remain payable in the expatriate's own country despite the requirement to contribute in Italy. If the expatriate is from another EEC country and is likely to remain in Italy for less than a year, it is possible for him to be allowed to remain a member of his own country's scheme and avoid Italian contributions. Even if employment in Italy continues after a year, this arrangement may be extended.

Expatriates and their employers will wish to ensure not only that long-term benefits such as pensions, unemployment, or disability pay are preserved, but also that risks of hospitalisation and medical treatment are adequately covered.

TERMS AND CONDITIONS OF EMPLOYMENT

Wage Rates

Rates have risen rapidly in recent years, and prospective investors will need to obtain current information from employers' organisations or the Ministry of Labour and Social Security.

All employees are grouped into categories, and national legal minimums have been fixed for each category. Because different social security contributions and employment conditions apply to the three main groups of categories — *dirigenti*, *impiegati*, and *operai*, the appropriate employment contract must always be completed. Clerical workers tend to be paid more than manual workers and have better employment conditions, although the trade unions are pressing for the elimination of differences. In practice, minimum wages for the different categories of employees are set by industry-wide collective bargaining agreements between unions and employers' associations, which are binding on all employees and employers. The basic rates provided by such agreements, however, are usually paid only to new employees or in other special cases, while experienced employees generally receive higher rates.

Limited negotiations are conducted by individual employers on such matters as production bonuses, job classifications, piecework rates, and some minor fringe benefits.

For time-based wages, hourly, daily, or weekly rates are usual for manual workers, and monthly rates for office staff. Two types of piecework pay are in use: full piecework and mixed piecework consisting of basic pay plus incentives.

Average hourly wages for manual workers in the manufacturing industry (excluding overtime) in January 1977 were from Lit.1,500 to Lit.2,000; monthly paid employees received from Lit.300,000 to Lit.500,000 according to category. The new three-year contracts entered into by many industries in the spring of 1976 typically provided for increases of Lit.25,000-37,000 per month in addition to the automatic cost-of-living increases.

While in theory under the constitution equal work by men and women ranks for equal pay, in practice there tend to be some differences because of the difficulty in defining 'equal work.'

Bonuses and Extra Compensation. In addition to basic pay, all employees are entitled to other compensation, such as a cost-of-living allowance (varying between categories) based on movements in the national cost-of-living index and adjusted quarterly, a production award generally computed as a percentage of basic pay plus cost-of-living allowance, and a seniority increase. A government plan to curb inflation and to help stabilise the value of the lira provides for the suspension of index-linked pay adjustments for all whose incomes exceed Lit.8 million per year, and for partial suspension for those with incomes between Lit.6 and 8 million. This will apply until April 1978.

Increases for seniority illustrate the complexity of Italian labour practices. They are regulated by collective agreements and vary according to category and seniority. For example, in the commercial sector the agreement specifies that ten increases shall be given at three-year intervals equal to 4% of basic wages and cost-of-living allowances. The textile sector's agreement specifies that for blue-collar workers, seniority increases of 1.5% of basic wages shall be given every two years, and for white-collar workers, of 5% every two years. In the chemical and pharmaceutical sector, white-collar workers and those with special qualifications are entitled to an increase of 5% every two years on 70% of basic wages; blue-collar workers' increases are 5% every two years up to a maximum of 25% of basic wages.

Labour Conditions

Furthermore, all collective agreements specify a Christmas bonus (also called the '13th month') payable in December. Certain types of businesses pay additional amounts; for example, commercial concerns pay a '14th month' in July, petroleum companies pay monthly salaries 15 times a year, and banks 16 times. The '14th month' payment in July is becoming normal practice for most types of businesses.

Some agreements also provide for meal or canteen allowances, which are part of the agreed remuneration, to be paid during holidays, vacations, and sick leave as well as during working time.

Special payments for hazardous work may also be stipulated, and senior managers often receive bonuses varying with real profits.

Overtime. Rates of overtime pay depend on the collective agreement concerned, and each category receives different premium rates. In the commercial sector, for example, overtime pay is 15% extra on basic pay over 40 hours to 48 a week, and 20% extra on all hours above that. The textile industry on the other hand pays 30% extra for the first five hours overtime worked during the day, and 40% thereafter; for overtime worked at night and during national holidays (daytime) 50% is paid extra, while for night work on national holidays the premium is 60%.

A special contribution of 15% of overtime compensation is paid to a national Unemployment Fund.

Annual and Other Paid Leave. There are at present 12 official public holidays for which regular pay must be given. In addition, each locality has a paid public holiday on the day of its patron saint. If any of these public holidays falls on a Sunday, another day's leave may be given or a day's wages or salary may be paid at the regular rate. Public holidays are listed in Chapter 5.

Every employee is entitled to a paid annual vacation, which depends upon his status and length of service, his employer's type of business, and the terms of the collective agreement concerned. In general, the minimum period is 30 calendar days, including weekends and any national holidays falling within the vacation period, or pro rata for employment of less than one year. Vacations are usually taken during the summer, at a time determined by the employer. On termination of employment, for whatever reason, employees are entitled to be paid for vacation time not taken.

In addition to holidays and vacations, employers are required to provide full or partial pay during sickness, accident, or childbirth, depending on the length of the absence. A proportion of this sick pay is provided by the social security system.

Payment Methods. Many companies pay salaries and wages by cheque or bank transfer, particularly in the northern part of Italy, although most industrial workers and lower-grade clerks are paid in cash.

Executives and staff members are paid monthly, while industrial workers are given an advance on the fifteenth of each month and the balance of their wages at the end of the month; the method of paying wages weekly (used mainly in the building trade) is gradually being eliminated.

When an employee is hired, he is given a letter stating his employment conditions and specifying his gross salary. It is rare to negotiate on the basis of net salary, although sometimes net salaries are found in the contracts of senior executives.

The employer is responsible for deducting the social security contributions and taxes due by the employee and forwarding them to the responsible authorities. At the end of each month, the employer must give each employee a pay slip showing his gross salary less social security contributions and taxes; a yearly summary is also required.

Working Hours and Conditions

Working Hours. The national labour contracts provide that normal working hours for employees cannot exceed 40 in any week, spread over not more than six days (except for special categories). Actual working hours are often less than the legal maximum and vary according to the collective agreement for each industry. In general, the average working week is between 38 and 40 hours. In most industries, commerce, and banking, the five-day week is in effect; in the retail trade, the same total hours are worked spread over five-and-a-half days.

Overtime work, except in emergencies, is not allowed unless approved by the official labour office. In any case, overtime hours are limited to 2 a day or 12 a week, with a maximum of 200 in a year. Special rules govern night work. Trade unions do not favour overtime work and prefer to see additional workers taken on.

Labour Conditions

Employment Contracts. The trade unions and employers' organisations conclude collective labour agreements on the general conditions of employment throughout the industry or trade concerned. These agreements generally last for three years and function broadly as contracts of employment. In addition, a written notice of employment is usually given to every new employee, although such a notice is not obligatory for hourly-paid workers. This notice must set out such details as place of work, date of commencement, rates of pay, grade or status, and length of the trial period, if any. Contracts for fixed terms are usually invalid.

Short trial employment periods are provided for in the national labour contracts. They are normally of six days for manual workers (unless the appropriate collective agreement provides otherwise) and from three to six months for other employees, depending on their status.

Many collective agreements provide that a prospective employee may be required to have a medical examination before engagement, as after engagement this is not generally allowed. All prospective employees must hold valid labour cards or work permits. Non-competition clauses designed to prevent an employee from joining a rival company or setting up his own competitive business are not forbidden by law, but are not usual. Such clauses are occasionally inserted in contracts with senior staff, as any such restrictive agreement must be in writing, must define the terms of the restriction, and must provide for adequate compensation to the employee.

The rules specified in employment contracts vary in regard to illness (up to one year), accident, maternity (during pregnancy and for one year after childbirth), military service, or marriage (generally from before the wedding date until one year after it). During these periods, or within three months thereafter, employees cannot be given notice of termination of employment.

Termination of Employment. Employers and employees alike must give notice of intent to terminate employment. The length of such notice is determined by the employee's work category, length of service, and the relevant collective agreement. In practice, notice periods by both employers and employees are usually from six to twelve days for manual workers, fifteen days to four months for weekly or monthly staff, and five to twelve months for executives. An employer who gives insufficient notice must pay an indemnity equal to regular pay for the period of notice, in addition to the normal severance pay described in the following paragraph. This indemnity is also paid on the death of an employee or upon retirement at the normal age specified by law. An employee who does not give adequate notice is subject to the loss of severance pay for the period not covered by the notice. An employee under notice does not have any rights to paid time off to seek another job.

Quite apart from notice periods or the payment of indemnities in lieu of adequate notice, all employees (except for those working trial periods) are entitled under the Civil Code to severance pay, regardless of the reason for termination of employment. Such pay is considered normal remuneration which has been deferred. For staff employees, severance pay is normally accrued for accounting purposes at the rate of one month's pay, including bonuses, per year, but the exact amount is determined by the category of employment, length of service, remuneration, and the terms of the appropriate collective agreement. In the case of executive managers, the amount may be increased by up to 50%, that is, to 1½ months' pay, including bonuses, per year, usually from original appointment for those in commerce, and for periods in excess of the first eight years for those in industry. For factory workers, severance pay varies with individual agreements, but generally amounts to one month's pay at latest rates for each year of service. The collective agreements also provide extra indemnities for individuals dismissed without just cause.

'Just cause' is defined by the Civil Code as some action that results in a loss of the good faith and confidence essential to a contract between employer and employee and thus includes such matters as violence, dishonesty, or continued indiscipline. Just cause is a ground for instant dismissal, without any payment in lieu of notice. Dismissal for just cause is thus different from dismissal for a 'justified reason,' which includes changes in the nature of the job, an employer's arrangements, or an employee's failure to carry out the terms of the contract for which normal notice rules apply. The just cause rule does not apply to group dismissals, to employees during the trial period, or to those who have reached 65 years of age or are entitled to a state pension; in these cases dismissal is allowed, but notice must be given.

Every dismissal must be for just cause or justified reason, and must be reported to the employee in writing. The employee can then follow the disputes procedure set down in the appropriate collective agreement, which may involve reference to a labour court. As a beginning, the employer may have to produce a written statement of his reasons for the dismissal. The burden of proof lies with the employer and is often difficult to establish. In general, the law favours employees rather than employers, and the courts in interpreting the law tend therefore to support the employee. Should the ruling go against the employer, he must either reinstate the employee or pay an extra indemnity, which may range from five to fourteen months' pay, depending on the size of the enterprise, the length of service, and the judgement of the court.

A final rule on termination pay concerns redundancy. If it becomes apparent that workers may become redundant, meetings must be held with their

Labour Conditions

representatives and union officials to find a viable alternative. If dismissal becomes the only solution, the redundant employees must be paid by their employer the equivalent of two-thirds of their aggregate pay for 180 days.

Other Employment Matters

The work of juveniles under the age of 15 is specifically regulated and the approval of parents or legal guardians is always required. Juveniles may be employed only on light work and for reduced hours; they may not work on night shifts nor be employed for any dangerous tasks or handle toxic substances. Similar rules about dangerous work and toxic substances apply to women, who in addition are entitled to paid maternity leave both before and after the date of confinement.

Every company is subject to visits or inspections by various government officials to ensure that labour regulations and rules for the safety of employees are being observed. Industrial establishments must keep a register of on-the-job accidents.

Every employer must allow student employees paid leave to attend vocational training courses, but the larger firms often grant additional leave up to 150 hours a year to any employee who desires to improve his general or technical education.

FRINGE BENEFITS AND SOCIAL SECURITY

Although employees contribute to social security costs, the major burden falls on employers. This burden, together with the cost of various fringe benefits, can easily add 75% or more to the cost of direct hourly pay. In this connection, the following definitions may be helpful:

Direct hourly pay

- This includes basic wages, cost-of-living allowances, production bonuses, seniority increases, merit raises, piecework and other pay adjustments, and sundry special allowances.

Indirect hourly benefits

- This is usually a computed hourly cost of such periodic benefits as Christmas bonus (13th month), holiday and annual vacation pay, special bonuses, and severance indemnities.

Fringe Benefits

This term applies not only to the voluntary benefits that vary from employer to employer or even between employees of an individual enterprise (for

example, the provision of benefits for children), but also to the indirect hourly benefits provided for by law or in collective agreements, as defined previously.

Annual and vacation pay and other paid leave entitlements, productivity and seniority bonuses, and indemnities on termination have already been described. Other fringe benefits often allowed are subsidised canteens and sports or social clubs, company housing or house loans at favourable rates, vacation bonuses, subsidised transport to and from work, clothing allowances, benefits for children (such as nurseries, kindergartens, subsidised vacations, and assistance for students), long service bonuses, company shops, and elderly people's homes.

Provision for these voluntary fringe benefits is growing and even smaller enterprises frequently offer them, sometimes in conformance with other firms of similar standing.

Private pension schemes are not widespread because of the high rate of social security pensions, although some employers arrange contributory provident funds that provide benefits on death or retirement for all grades of staff. Profit-sharing and share option schemes are rare, and are restricted to senior executives. Company cars are usually only allowed to salesmen and executives.

Social Security

The Italian social security system is comprehensive and costly, but the level of benefits, compared with earnings, is one of the highest in Europe. Only a few categories are not covered by compulsory social security, such as directors who are not employees.

Benefits. These include:

1. Retirement pensions, normally payable from age 60 for men and 55 for women. After 35 years of contributions, employees may receive the maximum annual pension of 80% of average earnings during the three highest paid years in the last ten years of insured employment, with a maximum average of Lit.12 million. Employment in other countries that have social security agreements with Italy (for example, the other EEC countries) applies toward the requirement for 35 years of contributions. A 1969 law provides for automatic pension increases geared to the cost-of-living index, and liberalised rules for pensioners who continue to work. Separate schemes for executives, linked to the state social sec-

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urity system, also provide for 80% of recent average earnings up to ceilings which are increased periodically. Reduced rates are payable to widows and orphans.

2. Unemployment benefits. These consist of Lit.800 per day (plus Lit.9,880 for each dependant per month) for any period of involuntary unemployment after the eighth day up to a maximum of 180 days per year. In order to claim this benefit, the unemployed worker must be registered at the labour exchange.

In cases of plant closure, temporary stoppage, or reduced working hours, workers receive 80% of gross wages up to 40 hours a week for three months (or six to twelve months in exceptional cases). An unemployed worker participating in job retraining receives an extra Lit.600 per day. Unemployed men over 57 or women over 52 receive special allowances if they are out of work and not eligible for a pension.

3. Family allowances. These are paid by the employer and are deducted from his liability for social security contributions. Each employee receives Lit.10,868 per month for his wife, Lit.10,868 for each dependent child under 18 (under 26 if attending a recognised school or university), and Lit.2,574 for each dependent parent and grandparent (Lit.2,946 or 7,150 for certain categories). Minor variations apply in certain cases.

These allowances are paid to foreigners working in Italy, even if their dependants are living in their home countries, provided those countries have reciprocal agreements with Italy.

4. Medical care and sick pay. Medical, surgical, and hospital care is free or almost entirely free, at least for 180 days in each year, but some charges are usually made for drugs and appliances. Special funds deal with tubercular patients, workers temporarily or permanently disabled by accident, and maternity benefits. Employees' dependants, and all pensioners, are covered.

In addition, the National Institute for Sickness Insurance (*INAM*) provides sick pay, supplementing the required employer's payments, on the following scale for commercial enterprises:

| Days of Sickness or Disability | % of Last Normal Pay Provided By INAM | Employer |
|-----------------------------------|--|----------|
| 1 — 3 | — | 100 |
| 4 — 21 | 50 | 25 |
| 22 — 180 | 66-2/3 | 33-1/3 |

In industry, the principle is similar, although the rates vary slightly.

The rates are reduced if the claimant is in hospital or has no dependants. In exceptional cases, the last period can be extended for up to a further 120 days. Sick pay then ceases, but disability benefits, based on the proportion of retirement pension already earned, become payable.

Because standards in the state health services vary, some people prefer to pay for private treatment, covering the cost by private insurance.

5. Other benefits. A low-cost housing fund, a fund for orphans, and an earnings adjustment provident fund to cover temporary plant closures and similar matters, also form part of the social security structure.

Costs. Contributions payable vary according to the type of business and category of employee. The following table shows the 1976 contribution rates for industrial workers as percentages of direct hourly pay:

| Payable To | Benefit | % Contribution By | |
|--|--|-------------------|-------------|
| | | Employer | Employee |
| National Social Security Institute (INPS) | Disability and old age pensions | 16.61 | 6.80 |
| | Unemployment | 1.61 | — |
| | Tuberculosis | 2.01 | — |
| | Orphans' pensions | 0.16 | — |
| | Family allowances | 6.50 | — |
| | Earnings adjustments provident fund | 1.00* | — |
| | | | |
| National Sickness Insurance Institute (INAM) | Medical care and sick pay | 13.96 | 0.30 |
| | Public housing scheme | <u>0.70</u> | <u>0.35</u> |
| | | <u>42.55</u> | <u>7.80</u> |

*3% for construction workers and 0.75% for employers with up to 50 employees.

In addition, contributions for accident coverage are payable to the National Institute for Insurance Against Injuries (INAIL) at rates varying with the risk.

Contribution rates for commercial employees are broadly similar, but there are minor variations.

Contribution rates for executive managers are about the same in total as for other employees; in general, however, the employer pays less and the

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manager more. Unemployment insurance, for example, is dealt with by personal contributions to executive managers' separate organisations. Arrangements differ between industry and commerce, and in some cases there are contribution and benefit ceilings.

Self-employed individuals must make their own insurance arrangements. Depending on the circumstances of the particular case, a director who is a substantial shareholder in his company may be treated either as self-employed or as an executive manager; if he is in fact an employee, he must join the social security schemes.

LABOUR-MANAGEMENT RELATIONS

The Italian Constitution provides for freedom of workers and employers to form unions or associations. The 1970 Labour Charter generally strengthened the rights of unions and gave greater freedom to employees; for example, by limiting employers' rights to downgrade or arbitrarily search their employees.

Collective Agreements

The general pattern of labour conditions is set by collective bargaining agreements which are signed by representatives of the unions and employers' organisations. These agreements usually last for two or three years and set the minimum conditions for a whole industry. Limited negotiations by individual concerns sometimes follow the signing of an agreement for a whole industry. National agreements covering all industries have also been signed on occasion.

Plant-level agreements, negotiated by individual concerns and supplementing the wider agreements, are becoming more frequent.

Unions

Italian unions (*sindacati*) are organised by industry rather than by craft, and tend to be associated with political parties. All categories of employees are represented by unions, although membership is not compulsory and comprises only about half the total labour force. Generally, the agreements which are negotiated by the unions apply to all employees and are not merely to union members.

The principal unions are:

1. *Confederazione Generale Italiana del Lavoro (CGIL)* — backed by the Communists and left-wing Socialists, they are particularly strong in the mechanical, steel, and construction industries, and among unskilled workers (membership about 3.8 million).
2. *Confederazione Italiana Sindacati dei Lavoratori (CISL)* — backed by the Christian Democrats, they are fairly strong in textiles and among government employees (membership about 2.4 million)
3. *Unione Italiana del Lavoro (UIL)* — backed by the Republicans and Social Democrats (membership about 1.5 million).

These three groups work closely together.

4. *Confederazione Italiana Dirigenti d'Azienda (CIDA)* — the nonpolitical union of managers and executives.

Italy has no provisions for compulsory arbitration, and disputes have to be settled between the local union executive and the employer. Perhaps as a result, Italy has the worst strike record in Europe, both in the public and private sectors. Days lost in a year per thousand employees, in almost every year since 1970, have been well over 1,000; and in the ten years between 1965 and 1974, averaged 1,665. These figures compare with 1,644 for Canada, 1,305 for the USA, 743 for the UK, 243 for Japan, 50 for West Germany and 1 for Switzerland.

Frequently, the unions have not had the large funds necessary to sustain prolonged strikes, and so have tended to rely on short strikes — some of only 24 hours' duration. Strikes in the public sector and the big corporations have been the main contributors to Italy's bad record, and labour relations in the many small enterprises that exist in most industries are, in general, much more stable. Union activity tends to increase before the signature of the periodic collective bargaining agreements.

One reason for the continuing union militancy, which resulted in further substantial wage increases early in 1976, may be the speed with which Italy has transformed itself into a complex industrial society. As a result of this change, many social problems have not yet been solved — such as poor housing, inefficient bureaucracy, suspicion of widespread tax evasion, corruption in public life, and the gulf between rich and poor — and until these are tackled, the unions may be unwilling to moderate their demands.

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Employers' Associations

The principal employers' organisations are:

1. *Confederazione Generale dell' Industria (Confindustria)* — the national federation of almost all Italian manufacturers, organised by area and industry associations.
2. *Confederazione Generale del' Agricoltura (Confagricoltura)* — the national association of all Italian farmers.
3. *Confederazione Generale del Commercio (Confcommercio)* — the national federation representing employers in trade and commerce.
4. *Delegazione Sindacale Interaziendale (Intersind)* — the national organisation for all state-owned industries.

These associations provide a wide range of advisory and information services for their members, and are also able to answer enquiries from potential foreign investors. There is an association in each province.

The Courts

Labour disputes are handled by the general civil courts in Italy; there are no separate labour courts. The Ministry of Labour and Social Security provides a mediation service and has the power to intervene in any dispute that threatens the national interest.

A National Council for Economy and Labour, composed of employers' and employees' representatives and independent experts, makes recommendations on labour matters; such recommendations, however, have no legal force.

Worker Participation in Management

Every enterprise employing 15 or more people must allow its employees to appoint one or more delegates to represent them in dealings with management. Alternatively, an enterprise of any size may allow the appointment of a factory council (*consiglio di fabbrica*) of up to 50 members on which manual workers and staff employees must all be represented.

The factory council is mainly an advisory body; nonetheless, it has the right to receive information on labour force movements and working conditions, it

must be consulted on questions of holidays and working hours, and it is charged with overseeing the enforcement of collective agreements. It may also make suggestions to management, although it does not have the power of veto as work councils in some other countries have, and cannot therefore be regarded as participating in management.

There are no requirements for boards of directors to include employee representatives.



CHAPTER V

Business Practices and Information

- GENERAL INFORMATION
- BUSINESS HOURS AND HOLIDAYS
- BUSINESS PRACTICES

GENERAL INFORMATION

Business practices and customs in Italy are much the same as elsewhere in the Western World. Businessmen in the South tend, however, to be less affected by the rapid pace of modern living than their associates in the North.

Although in business circles a knowledge of English and French, and other foreign languages, is quite common, interpreters or translators are sometimes required. They are available in all the large cities and can often be obtained through travel agencies or hotels. If an interpreter has to be used at a meeting, the technical points to be discussed should first be outlined to him.

Handshaking at the beginning and end of every meeting is customary and even a brief encounter demands a handshake. Among business associates and colleagues last names are used; first names are reserved for family and close friends.

It is not customary to be invited to an Italian businessman's home, although such invitations are sometimes made. On these occasions, flowers or some appropriate small gift is expected by the hostess. Business matters should not be discussed at these times, unless the host brings up the subject or wishes to have a discussion in private after dinner.

Best Travel Months

The best time for business travel to Italy is in the spring, early summer, and autumn. The main holiday period is from mid-July to mid-September, when hotels are crowded and many families are away from home; in August, particularly, businessmen are likely to be vacationing themselves. The weeks before and after Christmas are other times to be avoided.

Entry Requirements and Currency Restrictions

For long-term stays or to conduct business from an Italian base, entry regulations are as described in Chapter 4; for a fact-finding trip or a holiday visit, however, only a valid passport with, in some cases, a visa, is required.

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Currency and travellers' cheques can normally be exchanged at frontier posts, ports, airports, and main railway stations, banks and travel agencies, and even at many hotels and large stores. Exchange and commission rates vary, however, and banks usually offer the best terms. Foreign visitors staying at a hotel must produce their passports on arrival, when they will be automatically registered with the police; all others must report to the police within three days of arrival. There are no income tax clearance formalities for travellers on business when leaving the country. Personal articles and small purchases can normally be taken into or out of Italy free of duty, but to preclude evasion of the exchange control regulations not more than Lit.100,000 may be taken out of the country in Italian currency.

It is always advisable to check with a reputable travel agent or the Italian Embassy or Consulate before a trip, as travel and currency regulations and health and vaccination requirements may change at short notice.

Communications and Transportation

Italy's communications network is highly developed and is linked to the systems of adjacent countries.

The intercity telephone system is almost completely automatic, and direct dialling is possible to most of Western Europe, North America, Japan, South Africa, and other developed countries, and even to the Communist bloc of Eastern Europe. Telex facilities are widespread, with public call offices at the main post offices. Credit facilities for telephone, telex, and cables can be arranged. Generally, telex or telephone services are recommended rather than mail or cables, which sometimes can be greatly delayed.

To operate one of the many public telephones, a caller must normally insert a token (*gettone*) purchased beforehand at a nearby counter. In airports and at railway stations, public telephones may accept either tokens or ordinary coins.

Code numbers for postal addresses should be used; Rome, for example, is 00100, Milan 20100, and Naples 80100.

The national airline, *Alitalia*, as well as other major international airlines, connect Italy with all the world's principal cities. There are also some internal airlines. Rome and Milan handle most of the country's air traffic, although other airports dot the country and serve the major cities of the mainland and the islands.

The railways provide good service throughout the country. They are almost entirely state-owned, although there are still some private local lines. The

main expresses have sleeper and restaurant car facilities. Businessmen normally travel on a Trans-European Express (*TEE*), *super-rapido*, or *rapido*. The first two require prior booking and, being direct first-class trains only, are more expensive than other trains. An *espresso* and a *diretto* are long-distance trains, slower than the first group and more crowded, as they have both first- and second-class seats. It is advisable to reserve seats on these trains also, and this should be done no later than two hours prior to departure time. Seats may be reserved by phone (except on *TEEs* and *super-rapidos*), but sleeping cars can only be reserved at stations or ticket agencies. Reductions in freight rates in the South have been mentioned in Chapter 2.

The toll motorway (*autostrada*) system, mostly state-owned, of more than 5,000 kilometres (over 3,000 miles), superbly engineered, serves the whole country and has perhaps done more than anything else toward making the South more accessible. Other roads are satisfactory but slower. About two-thirds of all traffic, passenger and freight, travels by road. Petrol (gasoline) is expensive, but foreign visitors can obtain concessionary coupons. Private automobiles may be imported duty-free for personal use for a period of up to six months if a 'fuel and tourist card' (*Carta Carburante e Turistica*) is obtained in advance. Third-party insurance is compulsory. Alternatively, an automobile can be hired by a driver producing an international driving licence or his own national driving licence translated into Italian.

In cities, buses and streetcars (in Venice, waterbuses) provide an easy way of getting about. Taxi fares are higher at night than in the daytime. In some places, it is better to agree upon a fare for a trip beforehand, especially in small towns where ordinary automobiles without meters are often used as taxis. As in other countries, 'pirate' taxis should be avoided.

Italy's merchant fleet, partly state-owned, is the eighth largest in the world, and besides transocean services there are regular sailings up and down the long coastline, to the islands, and to neighbouring countries. Genoa, Naples, Trieste, Venice, La Spezia, Leghorn, Palermo, Bari, Brindisi, Taranto, and Ancona are the major ports, with Genoa handling the most freight and Naples the most passengers. Cagliari in Sardinia is being developed as a port. The Po river carries some freight, but otherwise river transportation is minimal.

Hotels and Restaurants

Hotels are officially graded, although the grades are not standardised throughout the country. For business travel, hotels in the categories Luxe,

Business Practices and Information

1, or 2 are recommended. Hotels in the northern cities tend to be more expensive than elsewhere, even including Rome; prices for a single room with bath in a Class 1 hotel in Milan range from about Lit.18,000-30,000 per night. At times of trade fairs or conventions, hotels are heavily booked and accommodations should be reserved in advance. A special Italian feature is the 'day hotel' (*albergo diurno*), found in many large cities. These day hotels provide all the conveniences of a hotel except a bed, and although expensive can be useful to a businessman who is spending only a few hours in a city.

Italian food and wine are as varied as its regions, and good restaurants are to be found everywhere. Dinner in a superior restaurant can cost about Lit.7,000-20,000 per person. A *trattoria* is a more modest type of restaurant, a *rosticceria* or *pizzeria* is a snack bar, and a *latteria* is a milk bar. A *bar* is a cafe in which coffee and pastry, as well as wine and liquor, can be obtained. Water, unless marked '*non potabile*,' is quite safe to drink.

Tipping

Although service charges are added to hotel and restaurant bills, it is customary to leave a small additional tip. Taxi drivers expect a tip of 200-300 lire. Porters usually charge 250 lire per bag and 100 lire for any additional item.

Small tips are also given to chambermaids, barmen, barbers, theatre ushers, and car-park attendants.

BUSINESS HOURS AND HOLIDAYS

The Working Day

Hours vary widely, as each city or district is allowed to fix times most suitable for its own citizens. Climatic conditions make midday closing for a siesta period advisable in the South, although not necessarily in the North. Nevertheless, the lunch hour is usually quite long everywhere — from 13.00 to 15.00 in the North and from 13.00 to 16.00 in the South. In all areas, however, an establishment that provides an employees' canteen (cafeteria) will normally have only one hour for lunch. Coffee or tea breaks during the day are not customary.

Working Hours

Because business hours depend on location and individual preference, the following can only be a general guide.

| | Morning | Afternoon | Weekdays |
|------------------------|---------------|--|----------|
| Retail stores | 9.00 to 12.30 | 15.00 to 19.30 (later before holidays) | 5½ |
| Factories and offices— | | | |
| in the North | 8.30 to 12.30 | 13.30 to 17.30 | 5 |
| in the South | 8.30 to 12.30 | 16.00 to 20.00 | 5 |

(In central Italy, afternoon hours are generally a compromise between those of the North and those of the South.)

| | | | |
|--|---------------|-------------------------------|----|
| Banks | 8.30 to 13.30 | — | 5 |
| Post Offices (main offices remain open till 21.00) | 8.30 to 14.00 | — | 6 |
| Government offices | 8.00 to 14.00 | — | 6 |
| Museums and galleries (closing days vary — frequently Mondays) | 8.30 to 13.00 | 16.00 to 19.00 (in summer) | 5½ |

Only top-level government employees will be in their offices after 16.00, but may occasionally see visitors by appointment from 17.30 to 20.00.

Public Holidays

The 12 national public holidays in Italy are:

| | |
|------------------------------------|-------------------------|
| New Year's Day | January 1 |
| Easter Monday | March/April |
| Anniversary of the 1945 Liberation | April 25 |
| Labour Day | May 1 |
| Republic Day | June (first Sunday) |
| St. Peter's and St. Paul's Day | June 29 |
| Assumption Day | August 15 |
| All Saints' Day | November 1 |
| National Unity Day | November (first Sunday) |
| Immaculate Conception Day | December 8 |
| Christmas Day | December 25 |
| St. Stephen's Day | December 26 |

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In addition, every city or region has a local public holiday on the day of its patron saint. For example, businesses in Milan will close on December 7, in Turin on June 24, and in Naples on September 19. In Rome, April 21 marks the foundation of the city. Public offices close on the afternoons before Assumption Day, Unity Day, Christmas, and New Year's Day.

When official holidays fall on a Tuesday or a Thursday, many large companies adopt what is known as 'making a bridge' (*ponte*) with the weekend, by allowing the Monday or the Friday as a holiday and recovering the extra time on the preceding or following Saturday.

Because of the variety of holidays, it is important to make local enquiries before any trip is planned to avoid the 'closed for business' sign.

Time Factors

Italy uses Western Continental European time, which is one hour ahead of Greenwich Mean Time. Daylight-saving time is observed from end-May to end-September, when clocks are set forward one hour. A standard Common Market system for hour-changing is now under discussion.

BUSINESS PRACTICES

Cards

Business cards are widely used and if printed in Italian the courtesy will be noted.

The use of credit cards is becoming more widespread. Internationally-known cards are accepted at airline offices, large stores, and other places normally dealing with foreigners. The use of Eurocheques has been described in Chapter 2.

Dates

The sequence in Italy, as in Europe generally, is day - month - year. The inscription 4/10/78 is read as October 4, 1978, not April 10, 1978, as in the United States. In 1971 Italy, like most other advanced trading nations, voted in favour of a new international standard for use when dates are expressed in figures only. Under this standard, which is not yet widely adopted, the sequence is year-month-day.

Writing Conventions

Figures in Europe, including Italy, are usually separated by periods, not by commas, but commas precede decimals. For example, 1.000,99 would be written in English-speaking countries as 1,000.99.

The figure seven usually has a line drawn across the stem, when written by hand, to differentiate it from the figures one and four.

Weights and Measures

The metric system is used officially for all weights and measures, although in many rural areas ancient measures are still used, mainly in buying and selling land. A common measurement in shops is the *etto* or 100 grammes (just under a quarter of a pound).

Temperatures are measured in Centigrade. Domestic electric current has a voltage of 220, with frequency 50 cycles AC, while industrial supply is at 380 volts. Plugs often have two round pins, but key-shaped plugs with earthed terminals are found in newer buildings. Light fittings are usually of the screw type. Plug adapters may be required for small appliances such as electric razors.



- PRINCIPAL BUSINESS ENTITIES
- CORPORATIONS – THE SpA FORM
- COMPANIES – THE Srl FORM
- BRANCHES
- PARTNERSHIPS AND OTHER ENTITIES

PRINCIPAL BUSINESS ENTITIES

Foreign investors may adopt any of the forms of business entity available to Italian nationals and are restricted only from engaging in certain activities summarised in Chapter 2, which require special authorisation. If a foreign enterprise is incorporated in a form with an equivalent in Italy allowing for judicial reciprocity, it may freely operate in Italy through a branch.

Business entities are governed by the Civil Code of 1942, as varied by subsequent acts dealing with the publication of information and the rights of shareholders and third parties. Further rules apply to specialised businesses such as banks and insurance companies. The word *società* refers to both corporate entities and partnerships.

Summary of Forms

The main forms of commercial enterprise are:

1. Stock corporation (*Società per Azioni* or *SpA*). This is the usual form for large incorporated companies, whether quoted on a stock exchange or not. The liability of shareholders is limited, and there is normally no restriction on the issue or transfer of shares or bonds.
2. Private limited company (*Società a responsabilità limitata* or *Srl*). This type of incorporated body is suitable for smaller and closely held enterprises. Again liability is limited, but bonds cannot be issued.
3. General partnership (*Società in nome collettivo* or *Snc*). This is the usual form of commercial partnership, in which all partners are jointly and severally liable for all its debts and obligations. A partnership is not a legal entity separate from the members who compose it, although it may acquire rights and assume obligations in its own name.
4. Limited partnership (*Società in accomandita semplice* or *Sas*). In this form, the general partners are fully liable for the partnership's debts, but there can be one or more limited partners liable only to the extent of the contributions they have made to the partnership. In a limited partnership

Forms of Business Entities

with shares (*Società in accomandita per azioni* or *Sapa*), the limited partners' capital is divided into transferable shares, and much of the law relating to corporations applies to it.

5. Branch of a foreign or domestic organisation (*Sede secondaria* or *filiale*). This is not a separate legal entity but is an establishment of its parent body, in whatever form that body carries on its business.
6. Other forms include the joint venture (*Associazione in partecipazione*), cooperative (*Società cooperativa*), sole proprietorship (*Imprenditore unico*), and civil partnership (*Società semplice*).

As an alternative to setting up a new enterprise, an investor may buy an interest in an existing Italian organisation or appoint an agent.

This chapter deals mainly with the *SpA* form, the entity usually adopted by a foreign enterprise for its Italian operations. The *SpA* is here described as a 'corporation' and the *Srl* as a 'company,' whereas in the other chapters the generic term 'company' is normally used to describe both forms.

CORPORATIONS — THE *SpA* FORM

The Italian corporation or *SpA* has the same major features as its counterparts in most other countries: limitation of shareholders' liability to the amount of fully paid share capital, legal existence separate from that of its members, and ease of transfer of ownership. It is the usual form of enterprise adopted when finance is to be raised from the public.

Formation

A corporation may be formed either by direct constitution or by public subscription. The direct constitution or simultaneous method is normally adopted as it is much simpler and quicker.

Formation by Direct Constitution. Under this method, at least two founder-shareholders meet to execute a deed of incorporation (*atto costitutivo*) before a public notary (a legal official appointed by the state to carry out various functions such as attestation of deeds and transfer of real estate). This deed must include or have attached to it the new corporation's articles of association (*statuto*) and together these documents, which must

be in the Italian language, constitute its foundation charter and bylaws. Matters to be dealt with therein are:

1. Name, address, nationality, and place and date of birth of each founder-shareholder and number of shares for which he has subscribed.
2. Name of the corporation and location of its registered office or legal address (*sede sociale*), which must be within Italy, and of any branch offices.
3. Purposes of the corporation.
4. Amount of subscribed and paid-in capital; the minimum to be subscribed is Lit.1 million.
5. Number, nominal value, and type of shares (*azioni*).
6. Value of any contributions in kind.
7. Principles by which profits will be distributed, including any amounts granted to promoters or founders.
8. Number and powers of directors (*amministratori*), specifying which of them have authority to act in the corporation's name.
9. Number of members of the board of statutory auditors (*collegio sindacale*).
10. Duration of the corporation (a corporation's life may be renewed).

Considerable freedom is allowed in the preparation of a corporation's articles, and virtually any provisions can be inserted provided they are not in conflict with the law, good order, and public well-being. The comments in this chapter therefore describe general, although not unalterable, practice.

The deed of incorporation and articles must be approved by the local court and registered in the Register of Enterprises and at the Chamber of Commerce as described in Chapter 2. On registration and payment of the appropriate taxes, the new corporation legally comes into existence. Until then, it is unable to enforce any contracts, and its founders are personally liable for any actions taken in its name, although it may ratify the founders' actions after incorporation.

Forms of Business Entities

Founders may be corporations or individuals, Italian or foreign. A founder need not be present at the incorporation meeting if he has given a notarised power of attorney to his representative or acts through a nominee. Incorporation by the direct constitution method is usually completed within three to four weeks.

Formation by Public Subscription. Although corporations are now invariably formed by the direct method, they may also be formed by public subscription on the basis of a prospectus. This must state the purpose, capital, main provisions of the articles, profits reserved for promoters, and date by which the incorporation will be executed. Such a prospectus, signed by the promoters, must be filed with a notary before being made public. A subscriber for shares must receive a public deed or an authenticated private document as acknowledgement of his subscription. After the entire capital has been subscribed, the promoters must send a letter to all subscribers stating a time (not to exceed 30 days) by which subscribers must pay in at least 30% of their contributions in cash. Unless the prospectus provides otherwise, the promoters must call a subscribers' meeting within 20 days following the date set for such payment. At this meeting, with a quorum present consisting of half of all subscribers, each subscriber has one vote regardless of the number of shares held, and resolutions may be passed by a majority of those present except that alteration of the conditions in the prospectus requires unanimous consent. Among the matters to be resolved at this meeting are the contents of the articles, the promoters' share of profits, and the appointment of directors and members of the board of statutory auditors.

General Conditions. Whether an SpA is formed by direct constitution or public subscription, the following conditions must be satisfied:

1. At least 30% of the share capital subscribed in cash must be deposited with the Banca d'Italia. This deposit does not earn interest and cannot be withdrawn until the new corporation has been officially registered by the local court. Such a cash deposit is not required when the initial capital has been contributed in the form of state securities. As no deposit is required on any subsequent increases in capital, corporations are often formed with the smallest practicable capital, which is then increased after formation.
2. Any necessary governmental authorisations must be obtained, including prior permission from the Treasury for capital issues in excess of Lit.500 million.

3. The deed of incorporation and articles or bylaws must be published in the Official Bulletin (*BUSARL*) together with notice of the filing of directors' appointments in the Register of Enterprises, and a summary must be published in the Official Gazette. Additionally, the corporation's formation must be noted in the General Record of Shares and Bonds (*Schedario Generale dei Titoli Azionari*) kept in Rome.
4. In all new corporations, the directors and statutory auditors must verify the value of any assets other than cash contributed in exchange for shares, and an expert appointed by the court must submit a sworn statement of valuation which is attached to the deed of incorporation. Should the value assigned to these assets be less than 80% of the value stated in the articles, the share capital must be reduced proportionately. If the corporation is listed (quoted) on a stock exchange, the independent auditors described in Chapter 7 are in future to act in place of the statutory auditors.
5. The only rules concerning the name of a corporation are that it must not be so similar to the name of any other corporation that confusion may occur and that it must include the words '*Società per Azioni*' or the abbreviation '*SpA*.'

Formation Costs. A registration tax is levied on the initial issue of capital and on any subsequent increases. The tax rates are based on the form in which capital is contributed, as follows:

| | % |
|---|---|
| Cash, inventory, machinery, or other moveable goods | 1 |
| Industrial buildings and factories | 4 |
| Nonindustrial buildings and land | 8 |

Fees charged by public notaries vary, depending on the size of the share capital, from Lit.60,000 to Lit.200,000. Registration expenses at the local court are Lit.45,000. Other minor taxes and routine expenses are involved. If professional advisers such as lawyers, accountants, or translators have been engaged, provision for their fees should not be overlooked.

Ownership — Shares and Shareholders

Shareholders may be individuals, Italian or foreign. Corporations may also be shareholders if their holdings are consistent with the objectives set out in their articles of association. Minor restrictions concerning foreign shareholders are described in Chapter 2.

Forms of Business Entities

In practice there must always be two shareholders. Although it is not illegal for all shares to be held by a single shareholder, such a shareholder cannot claim the privilege of limited liability and becomes personally liable for all the corporation's debts incurred while he is the sole shareholder. It is quite legal for the second shareholder to be a nominee of the first, so that a corporation can in practice be a wholly-owned subsidiary of another.

Except as part of a scheme for the reduction of capital, a corporation may not purchase its own shares unless so authorised by a shareholders' meeting and must use for this purpose only funds derived from net profits properly ascertained. Such shares must be fully paid; they do not carry votes, nor may the directors dispose of them. Subject to the same conditions, a corporation may purchase shares of its parent corporation.

The Civil Code allows both registered and bearer shares, but for tax reasons (before the recent reforms), and unlike the rest of Continental Europe where bearer shares are usual, all shares in Italy whether partly or fully paid-in must be in registered form (*azioni nominative*). An exception is made for the 'savings shares' described later. Evidence of title is a share certificate which must contain the information required by the Civil Code — in particular, the rights and obligations of the holder. All shares must have a nominal or par value and cannot be issued for less than this amount; they may be issued at a premium, but there is no particular advantage in doing so. A transfer of registered shares is effected by endorsement of the share certificate with the name of the transferee and the signature of the transferor, authenticated by a notary or stockbroker; transfer is only complete when it is recorded in the corporation's register of shareholders.

Unless stipulated otherwise in the articles, shares are freely transferable, but shares issued other than for cash must be blocked by the corporation until the value of the assets contributed is verified. Normally no restriction on approval of transfer by the directors or other shareholders may be included in the articles, although a condition is often inserted requiring that shares shall first be offered to other shareholders.

Generally all shares are of equal par value and carry equal voting rights of not more than one vote each. The articles may, however, limit the voting rights of the various types of preferred shares in return for special rights to the distribution of profits and of assets on dissolution, but no more than 50% of the total share capital may be so limited.

Five types of shares may be issued:

1. Ordinary or common shares (*azioni ordinarie*). These entitle the owner to a proportionate share in the available annual net profit and in the net

assets in case of liquidation and the right to subscribe to any issues of new shares or convertible bonds.

2. Preferred shares (*azioni privilegiate*). These confer special preferences to holders as described above but generally do not give voting rights in ordinary corporate matters.
3. Benefit shares (*azioni di godimento*). Former holders of redeemed shares may be assigned such shares, which normally do not carry voting rights. Benefit shares ordinarily participate in residual annual profits after ordinary shareholders have received dividends equal to the ordinary legal interest rate (of 5%) and, in case of liquidation, after ordinary shares have been repaid at least to par value.
4. Employees' shares (*azioni a favore dei prestatori di lavoro*). These are shares issued out of profits made, entitling employees to a share in the profits. The corporation's capital stock must be increased by the assigned value of such employees' shares, which are usually subject to some restrictions on transfer.
5. Nonvoting savings shares (*azioni di risparmio*). These are similar to preferred shares, but are issued only by corporations listed on a stock exchange. They normally have votes only on resolutions affecting their own rights, and are pre-preferential as to dividends, usually of a cumulative 5%. They also have participating rights in residual profits and repayment priority on dissolution. Savings shares may be issued in bearer form.

Management

Ultimate authority over an Italian corporation lies with the shareholders in general meeting, although day-to-day management is delegated to the directors.

The formal division of duties between a management and a supervisory board found in some European countries has only partly been adopted in Italy in the form of the board of 'statutory auditors' described later. The alternative form of checking on management through the requirement that the financial statements presented to shareholders be subject to independent audit by professional accountants has not been adopted in the past in Italy. The boards of statutory auditors may lack professional qualifications and experience to perform an independent audit as understood, for example, in English-speaking countries. A law of 1975, however (explained in Chapter 7), provides for more meaningful audits in the case of listed corporations in future.

Forms of Business Entities

Directors

A corporation may have either a sole director (*amministratore unico*) or a board of directors (*consiglio d'amministrazione*) of whatever size is specified in the articles of association or by the shareholders in general meeting. The board may contain executives and independent members as the shareholders may decide. A corporation's articles may impose special requirements, but generally the position of directors is as described below.

Appointment, Removal, and Remuneration. Directors need not normally be Italian citizens or residents, nor need they be shareholders in their corporation. The first directors are appointed in the articles, but thereafter directors are elected by the shareholders. Vacancies are filled through interim appointments by the board, subject to approval of the board of statutory auditors. Directors' terms of office may not exceed three years, but they may be reelected. On appointment, a new director must file a notice of acceptance with the Register of Enterprises within 15 days.

A director may be removed at any time by resolution of a shareholders' meeting, although he may claim damages for removal without cause. A director may resign only if the number of directors left is at least half the required number. Otherwise his resignation will become effective only when a majority of the full board has been reestablished by the appointment of a new director. If for some reason all the directors retire from office, a general meeting must be held to appoint new ones, and in the interim the board of statutory auditors is empowered to direct the business.

Directors' remuneration or compensation, including any share of profits, is normally set out in the articles of association or fixed by the shareholders in general meeting. The remuneration of directors appointed to hold executive office in accordance with the articles is fixed by the board after consultation with the board of statutory auditors.

Changes in the composition of the board of directors must be filed in the Register of Enterprises.

Powers and Duties. Directors are responsible for the management of the corporation. In particular, at the annual meeting they must submit a balance sheet, profit and loss statement, and a report of their conduct of the business for the year.

Directors' powers and duties are generally set out in the articles of association. If provided for in the articles or approved by a shareholders' meeting, the board may delegate some of its powers to an executive committee

(*comitato esecutivo*) or to one or more general managers (*direttori generali*) or managing directors (*amministratori delegati*). Every board must have a chairman (*presidente*) elected by the directors or the shareholders. Normally this chairman is the corporation's legal representative, but the board may also grant powers of legal representation to the managing directors or to other executives. In doing so the board (or the articles of association) may place limits on these legal representatives' powers which must be filed in the Register of Enterprises and published in the Official Bulletin. Normally, however, none of these limitations is valid against third parties, and a corporation cannot use them to avoid its responsibilities under any contract that the legal representatives may have entered into. The corporation itself can, of course, take action against any such legal representative who has caused it loss by exceeding the powers granted to him.

All directors and general managers are liable to the corporation for any failure to fulfil their duties. Furthermore, if any individual shareholders or third parties are directly harmed by any fraudulent or negligent acts of the directors, they may sue them for damages. As a guarantee of the proper performance of his duties, every director must provide a bond equal to 2% of the corporation's share capital, although the articles of association may limit this bond to a maximum of Lit.200,000. The director's bond may be cancelled only after the balance sheet of the last financial year in which he holds office has been approved at the general meeting of shareholders. The bond may be in the form of the corporation's own shares or in government bonds.

Meetings and Procedures. Meetings need not take place in Italy, unless the articles provide otherwise. In some countries the place where directors' meetings are held determines residence for taxation purposes (subject to double taxation agreements); care must therefore be taken to avoid dual tax residence if directors' meetings take place abroad.

A board meeting is duly constituted if more than half the directors are present; notice of meeting is usually given by registered letter, and no fixed period of notice is prescribed by law. Resolutions are passed if approved by a majority of those present unless the articles provide otherwise.

Directors may not vote by proxy. If no chairman has been elected by the shareholders, the board elects its own chairman. This is important because the articles of many corporations give the chairman a casting vote. Minutes of meetings must be kept in the Italian language.

A director may not compete with his corporation in business, either alone or as a general partner in a partnership. If a director has a conflict of interest,

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he must inform the other directors and the board of statutory auditors and may not vote on the matter concerned. If he does so, he may be held liable for any damage suffered by the corporation as a result of his action, and the resolution may be annulled at the request of the board of statutory auditors or of any other director who did not vote in its favour.

A director, statutory auditor, or other officer of a company who contracts a loan or guarantee from it or from any other group company is liable to imprisonment and heavy fines. An exception to this rule is made for companies whose object is to extend credit.

Statutory Auditors

Every corporation must have a board of statutory auditors whose members (*sindaci*) are responsible for supervising the directors and safeguarding the shareholders' interests, inspecting the corporation's holdings of cash and securities periodically, examining the annual financial statements, and generally ensuring that the corporation is operating within the law.

It will be understood from this list of responsibilities that the board of statutory auditors does not set out to perform an independent audit as understood in many other countries. Because of its involvement in the control of the directors, it is more akin to the supervisory boards found in northern Europe, or at least to the commissaires of French or Belgian corporations. Members of the board of statutory auditors must attend all directors' and shareholders' meetings.

The separate audits of listed corporations by independent professional accounting firms that are to be introduced shortly will be described in Chapter 7.

The first *sindaci* are named in the articles of association. Subsequently they are appointed by the shareholders in general meeting for three-year periods; they can be reelected. A resolution to dismiss a statutory auditor requires the court's approval after hearing all parties concerned. On the death, resignation, or dismissal of a statutory auditor, an alternate takes his place. There must be either three or five *sindaci* making up a board of auditors, with two alternates. *Sindaci* may be shareholders, but cannot be employees or directors, nor be closely related to directors. They need not be Italian nationals. Every corporation with a capital exceeding Lit.50 million must select at least one *sindaco* in a three-member board, or two in a five-member board, and one alternate from an official register of auditors (see Chapter 7), while every smaller corporation must ensure that at least one member and one alternate must be a trained bookkeeper, accountant, or solicitor on an official list of professionals (*albi professionali*).

The *sindaci* are jointly liable with the directors for the acts or omissions of the directors. Their remuneration or compensation is fixed either in the articles or by the shareholders in general meeting and is usually based on the corporation's capital. The *sindaci* must meet at least once each quarter and must appoint as chairman of their board one of the members selected from the official register.

Shareholders in General Meeting

Meetings are classified as ordinary (regular) or special, according to the business to be transacted. They are usually held at the corporation's registered office but may be held anywhere in the world if the articles so allow. Ordinary meetings (*assemblea ordinaria*) must be held at least once a year and within four months following the end of the corporation's accounting year, unless the articles of association specifically allow a longer period. Normal business at such a meeting includes the election of directors and statutory auditors and the fixing of their remuneration, the approval of the financial statements, and any other matters specified in the articles. An ordinary meeting is called by an insertion in the Official Bulletin at least 15 days before the meeting date, although the articles may also require written notice to each shareholder. At such ordinary meetings, a quorum normally consists of shareholders representing at least 50% of the shares (excluding shares with limited voting rights), but if insufficient members are present and the meeting is adjourned, no quorum is then prescribed. A simple majority of votes present is usually sufficient to pass resolutions. If all shareholders, directors, and statutory auditors are present, the 15-day notice rule may be dispensed with. Minutes of meetings must be kept in the Italian language. Shareholders prove their identity by depositing their share certificates with the corporation or its agent beforehand, receiving in exchange an authorisation to attend the meeting.

Special meetings (*assemblea straordinaria*) may be called by directors in the same manner as ordinary meetings. They must, however, be held in the presence of a notary. They are usually required to deal with such matters as changes in the articles or new capital issues, or the winding up of the corporation. At special meetings, a majority vote of all share capital (including shares with limited voting rights) is required to pass a resolution. In the case of a listed corporation, if at two successive meetings insufficient shareholders have been present, a resolution can be passed at a third special meeting with the favourable vote of only 20% of the shareholders (or, in special cases, 33⅓%).

Shareholders representing at least 20% of the share capital may require the directors to call a special meeting. If the directors fail to do so, the statutory auditors or the court may call the meeting instead.

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Shareholders may appoint proxies, but only in writing. Directors, statutory auditors, or employees of the corporation may not act as proxies, nor may banks. Shareholders may not vote on resolutions in which they have a personal interest, but their shares may be counted for purposes of meeting quorum requirements. Votes in writing are not permitted.

Resolutions passed at special meetings must be published in the Official Bulletin. Any shareholder who dissents from a resolution changing the corporation's objects or legal form, or transferring its principal place of business out of Italy, may require the corporation to redeem his shares at a fair price.

Shareholders who believe that their rights have been infringed or that they have suffered loss because of any action taken by the directors have various remedies. They may request the court to annul a resolution or to order an investigation into the corporation's affairs, or they may sue the directors for any personal loss incurred or (by resolution of an ordinary meeting) require the corporation itself to sue the directors for any loss suffered by it.

Capital, Reserves, and Dividends

Share Capital. The minimum capital required by a corporation is Lit.1 million. The whole of the capital stated in the articles of association must be subscribed for, as there is no recognition in Italy of a difference between authorised and issued capital. However, only 30% of the capital need be paid in on formation, and the balance may remain outstanding for as long as the directors see fit. Share capital must be expressed in lire.

Capital contributions must normally be in the form of cash, but the articles of association may provide for contributions in the form of other assets, provided that the formalities described earlier in this chapter are observed. Capital increases can only be made with the approval of shareholders because any increase involves an amendment to the articles of association, and new issues must normally be offered first to existing shareholders and holders of convertible bonds.

Loan Capital. Bonds (*obbligazioni*) may be issued, but only to a limited extent. They may exceed the amounts of paid-in share capital only if they are secured, normally by mortgage on the corporation's real estate. Floating charges on the whole of a corporation's assets are not recognised in Italy. Bond issues must be approved by the shareholders in special general meeting, and those exceeding Lit.500 million must, like share issues, be

approved by the Treasury. Convertible bonds may be issued. Bonds are usually in bearer form (*portatore*).

Reserves and Distributions. Every corporation is required to accumulate a legal reserve by allocating at least 5% of its annual profits after tax until the reserve reaches 20% of the share capital. Should the reserve then be decreased by losses, the annual allocation must be reintroduced until the 20% level is reestablished. Any share premium or paid-in surplus received may not be distributed until the legal reserve has reached the required level. The articles may require that other reserves be maintained; these are referred to as 'statutory reserves.'

Asset revaluations are allowed only in very restricted circumstances (see Chapter 7); some corporations credit revaluation surpluses to separate reserve accounts, but others pass them through the profit and loss account.

While the directors may propose to transfer part of the profit for any year to reserves, the shareholders must approve all profit appropriations and may even insist on the whole amount available being distributed as dividends. The payment of interim dividends is not allowed.

Dividends may be in stock or in specie, providing the shareholders approve and withholding tax is properly computed and paid over to the tax authorities; such tax could be recovered by the corporation from its shareholders.

The proportion of net profits after legal reserve transfers that may be allocated to the promoters of a corporation is limited by law to a maximum of 10% for five years; founder-shareholders may be given similar benefits.

Losses. If accumulated losses exceed one-third of share capital, the directors must call a shareholders' meeting to reduce the capital in proportion to the losses. Should accumulated losses reduce the capital below the legal minimum, the corporation must recapitalise or convert into an *Srl* or be liquidated. No dividends may be paid until any losses brought forward have been made good.

Registration and Publication Requirements

The requirements concerning the publication of information by Italian corporations are extensive and complex. They are summarised in the accompanying table. Information to be produced for taxation purposes is described in Chapter 8 and requirements concerning business stationery in Chapter 3.

Forms of Business Entities

REGISTRATION AND PUBLICATION REQUIREMENTS IN ITALY

| Subject | Register of Enterprises (<i>Tribunale</i>) (page 21) | Chamber of Commerce (page 22) | Official Gazette (page 10) | Official Bulletin (BUSARL) (page 10) | CONSOB (for listed corporations) (page 111) | Schedario Generale (page 85) |
|---|--|----------------------------------|-------------------------------|--|---|---------------------------------|
| Deed of incorporation and articles (SpA, Srl, Sapa, branch) | • | • • | • | • | | • |
| Partnership deed | | | | | | |
| Notification of formation | | | | | | |
| Appointments and changes of directors or statutory auditors | • • • | • | | • • | | |
| Limits on directors' powers | | | | | • | • |
| Bond issues | | | | | | |
| Changes in articles or deed, e.g., registered address, nature of business, capital, bylaws, and powers of representation. (Note: After each change a complete new copy must be filed.) | • • | • | | • • | • • • | |
| Appointments and changes of independent auditors | | | | | | |
| Half-yearly reports | | | | | | |
| Notices of shareholders' meetings (Annual financial statements (SpA, Srl, Sapa, branch) | • • | | • | • | • • | |
| Shareholders' resolution adopting financial statements | | | | • | • | |
| Shareholders' resolutions passed at special meetings | | | | | | |
| Dividends and interest payments | | | | | • | • |
| Proposed mergers | | | | | | |
| Acquisitions of 10% or more of share capital of another corporation (2% if the other is also listed) | | | | | • • | |
| Cessation of trade and appointment of liquidator | | | | | | |
| Final balance sheet on conclusion of liquidation | • • • | • | | • | | |
| Court order for dissolution | | | | | | |

Dissolution

A corporation may be liquidated and dissolved:

1. On expiration of any fixed term for which it was formed or when it has achieved its objects or they become impossible to attain or for any other reason set out in the articles of association.
2. By resolution of the shareholders at a special general meeting or by the court if the shareholders are deadlocked on the matter.
3. When the capital is reduced by losses below the legal minimum or where the court orders the nullity of the corporation because of some defect in its formation procedures or articles.

Liquidators must then be appointed to wind up the corporation and the directors may not commence any new transactions. A final balance sheet, showing funds available for creditors and shareholders, and a final report of the statutory auditors must be filed by the liquidators with the Register of Enterprises. After three months, if no shareholder has disputed the balance sheet, the liquidators may distribute the corporation's funds. Thereafter the court order dissolving the corporation must be published.

On a merger, some of the formalities for liquidation and formation are dispensed with; for example, assets are not treated as having been realised for the purpose of property appreciation tax, and registration taxes are charged at half the usual rates. Other rules have been made to facilitate mergers with corporations in other EEC countries.

A merger must be approved at special meetings of the corporations concerned, and the relevant resolutions must be published in the Register of Enterprises and Official Bulletin in order that creditors and other interested parties may have the opportunity to object to the proposals.

COMPANIES — THE Srl FORM

The limited company or *Srl* is a form of enterprise available to a small group of associates who wish to operate with limited liability without being bound by the formalities of the corporation form, which is appropriate for larger enterprises with hundreds or thousands of shareholders. It corresponds therefore to the German *GmbH* or the French *Sàrl*. Like the *SpA*, the liability of its members is limited to its own assets.

Forms of Business Entities

Organising and operating an *Srl* requires most of the same procedures as for an *SpA*. Consequently, because foreign investors generally use the *SpA* form and only those considering limited operations or small initial investments are likely to be concerned with *Srl* companies, only the principal differences between the two forms are described here.

The minimum capital required is Lit.50,000; there is no maximum. Capital is not divided into shares, but members' interests are described as quotas or parts. Individual quotas, which cannot be smaller than Lit.1,000, are recorded in a register of members and are not represented by negotiable documents. They may be transferred only by assignment or inheritance, subject to any restrictions in the articles of association, and may not be repurchased by the company.

Quotas may be of different sizes (like shares in a partnership) but must be in multiples of Lit.1,000. A member's liability is limited to the amount, if any, unpaid on his own quota. Votes are in proportion to the size of the quotas — one vote per Lit.1,000 — and neither limited nor multiple voting rights are allowed. At an ordinary meeting a resolution is passed by a simple majority of votes, but at special meetings, two-thirds majorities are required.

An *Srl* may not issue bonds or debentures. Its name must indicate that it is an *Srl*. An *Srl* must have one or more directors who must also be members, unless the articles stipulate otherwise, and who may be appointed for terms longer than three years. It must have a board of statutory auditors if its capital is Lit.1 million or more, constituted like that of an *SpA*. In very small companies where auditors are not legally required, every member may examine the books of account and ask the directors for information. The financial statements of an *Srl* must be filed with the Register of Enterprises and in the Official Bulletin, just like those of an *SpA*.

BRANCHES

Foreign companies may do business in Italy by setting up a branch office (*Sede secondaria* or *filiale*), which must be registered within 30 days of its establishment. Registration consists of filing with the Register of Enterprises:

1. The company's own charter of incorporation and articles of association.
2. Latest financial statements.
3. Resolution authorising the setting up of the branch.

4. The names and signatures of those authorised to act on behalf of the branch. (The names of the parent body's directors do not have to be filed.)

Together with copies in Italian, these documents must have been notarised by an Italian consul in the country of origin and by the Ministry of Foreign Affairs in Rome. The branch must also register with the local chamber of commerce and publish the above information in the Official Bulletin. Persons acting on behalf of the branch have unlimited personal liability if they fail to comply with these formalities. The cost of registration and the time taken is about the same as for setting up a corporation, although a branch does not have to make any minimum capital deposit.

After registration the foreign company is liable for all debts and obligations incurred by its Italian branch and must file with the Register of Enterprises its own financial statements in addition to those of the branch. The branch becomes subject to Italian law and must always have a resident representative in the country. All changes in the information in the Register of Enterprises must be filed. Each branch establishment must be registered and is subject to a separate registration tax.

There are some disadvantages in the use of a branch as compared to an *SpA*, and as a result few foreign companies have established branches in Italy. Not only is it impossible to limit liability to the capital of the Italian branch or to merge the branch with an Italian corporation, but the parent may also be involved in inquiries into branch affairs, as its own annual financial statements must be filed with the Register of Enterprises. It may be difficult to make local officials understand the organisation of the foreign parent and the basis for allocating costs to the branch for tax purposes. As a result, the Italian tax authorities may arbitrarily consider a portion of the parent company's profit as being produced by and taxable on the branch. These factors are considered further in Chapter 8. On the other hand, administration of a branch is simpler than of an *SpA*, as it does not have to have directors, statutory auditors, or shareholders with the consequent need for meetings and minutes. Furthermore, it may carry any amount of losses in its books without having to recapitalise.

Italian entities may also establish branches.

PARTNERSHIPS AND OTHER ENTITIES

General Partnership

In this form, all partners are jointly and severally liable for all the firm's debts and obligations. A general partnership is governed by the Civil Code and,

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although not a separate legal entity, can acquire rights and assume obligations in its own name. It is not clear whether another legal entity (for example, a foreign corporation) can be a partner of this type of partnership — a matter usually determined by the attitude of the court in the city where registration is accomplished.

The name of a general partnership must consist of the names of one or more partners together with the words '*Società in nome collettivo*.'

There is no minimum capital requirement and partners' contributions may be in cash or kind. The transfer of a partner's interest requires approval of all partners, and distribution of profits and losses is governed by the partnership agreement or, in the absence of an agreement, is based on capital contributions. There is no requirement for public disclosure of financial statements, but the partnership agreement must be filed in the Register of Enterprises and published in the Legal News Bulletin, and the partnership must register with the local chamber of commerce. The time and cost involved in forming a partnership are much the same as for an *SpA*.

A new partner's liability extends to all obligations existing at the time of his admission. Upon retirement, a partner must notify third parties, and he remains liable for all obligations which arose before his retirement. The death of a partner does not dissolve the partnership unless the agreement so provides. All partners may manage and represent the partnership, or the partnership agreement may designate certain partners only as managers. The partnership agreement must contain provisions broadly similar to those in the articles of association of a corporation. On dissolution of a partnership, liquidators must be appointed as for an *SpA*.

Limited Partnership

A *Società in accomandita semplice (Sas)* must have at least one general and one limited partner. Its name must include the name of at least one general partner and words designating it as a limited partnership.

General partners (*accomandatari*) are jointly and severally liable for all debts and obligations of the partnership, while limited partners (*accomandanti*) are liable only to the extent of their capital contributions. However, if a limited partner's name appears as part of the firm's name, he incurs the same unlimited liability as a general partner. If a limited partner manages the firm in any way, he incurs the liability of a general partner (although he may work for the firm in a single transaction under a special power of attorney or under the managers' direction). The appointment of managers requires the approval of all the general partners and of such limited partners

as represent the majority of limited partners' capital. All partners are entitled to receive copies of the annual financial statements and information concerning the partnership's business. Filing and publication requirements are the same as for a general partnership, but the partnership agreement must disclose who the general partners and who the limited partners are.

The transfer of a partner's equity requires the approval of partners representing the majority of capital, unless otherwise stipulated in the partnership agreement. The equity of a limited partner may be transferred by reason of his death.

Partnership Limited by Shares

The *Società in accomandita per azioni (Sapa)* combines certain features of a limited partnership and a stock corporation. It is a legal entity, and the limited partners' interests are represented by transferable shares. Those designated by the partnership agreement as general partners have joint and several liability for the whole of the partnership's debts and obligations, but the limited partners are liable only to the extent of their capital subscriptions.

Because a *Sapa* is an incorporated partnership (with certain unlimited members), the legal provisions in the Civil Code concerning it are almost identical to those for an *SpA*. The *Sapa* is the only type of partnership that may raise additional capital by issuing bonds. The general partners act as directors, and a board of statutory auditors must be appointed, just as in an *SpA*.

Sole Proprietorship

An individual (*Imprenditore unico*) may engage in trade and may sue or be sued under his trade name, although he is personally liable for all the proprietorship's debts and obligations. Like partnerships, sole proprietorships must be registered. Foreigners as well as Italians can generally carry on business as sole proprietors without any restriction.

Joint Venture

The joint venture (*Associazione in partecipazione*) is often used for a limited purpose or term, for example, by large-scale construction contractors or financial syndicates. One manages the contract on behalf of the others. The other parties may or may not participate in losses and, in many respects, are similar to silent partners in Germany and other countries. Unless expressly agreed upon in the contract, the first party cannot grant

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interests in the same venture to other persons without the consent of the existing partners. Neither the joint venture agreement nor the names of the parties to it need be filed in the Register of Enterprises.

The joint venture does not have a firm name and cannot therefore sue in its own name, nor can it be sued. Third persons acquire rights and assume obligations only towards the active party who is responsible for the management of the venture. The contract may specify the nature of supervision that can be exercised by the other parties over the venture. In all cases, the other parties are entitled to receive financial statements for the venture and annual financial statements if it continues for more than one year.

Other Forms

A cooperative society (*Società cooperativa*) is sometimes formed to further its members' joint research, marketing, or other functions. A member's interest may not exceed Lit.250,000, and changes in membership must be approved by the board of directors.

A civil partnership (*Società semplice*) is similar to a general partnership but is not allowed to engage in industry or commerce. It is sometimes used to hold real estate.

There is no equivalent in Italy of the trust in Anglo-American or Liechtenstein law or the foundation in Dutch or German-speaking countries.



CHAPTER VII

Accounting and Auditing

- FORM OF FINANCIAL STATEMENTS
- ACCOUNTING PRINCIPLES AND PRACTICES
- AUDIT REQUIREMENTS AND PRACTICES

- PROFESSIONAL ACCOUNTING AND AUDITING ORGANISATIONS
- BOOKS AND RECORDS
- SPECIMEN FINANCIAL STATEMENTS

FORM OF FINANCIAL STATEMENTS

Layout and Content

The recently amended Civil Code broadly sets out the required contents of the balance sheet and also, in much more detail, defines the contents of the profit and loss account or income statement. It does not, however, prescribe the use of standard reporting forms or charts of accounts. Besides the Civil Code requirements, tax regulations have exercised a strong influence on the presentation of financial information. By contrast, the accounting profession and the stock exchanges have had little influence on the form or content of Italian financial statements, and as a result they are usually not very informative. The National Commission for Corporations and the Stock Exchange (*CONSOB*) is required to formulate accounting standards for companies listed on the stock exchange, and one committee representing accountants in public practice and another those in universities and commerce were discussing accounting and auditing standards when this study was being written. Consolidated statements are neither required by law nor published in practice.

In the Italian balance sheet, assets appear on the left-hand side, more or less in order of liquidity. Shareholders' equity and liabilities appear on the right, beginning with capital and reserves, then depreciation and other provisions, long-term liabilities, current payables, and finally earnings for the year before taxes or distributions. As it is illegal to offset balances, such items as accumulated depreciation or provisions for doubtful accounts appear opposite the assets to which they relate. Such items as directors' guarantees or discounted bills, often shown by way of note in other countries, appear in the balance sheet on both sides and are added to the balance sheet totals after the subtotals of the assets and liabilities. The double-sided form of income statement is usual, and while considerable detail must be disclosed, significant figures such as cost of sales or profit before tax are not readily apparent. Financial statements must be presented in the Italian language and in lire. Many listed companies give additional accounting or statistical information in the directors' report (*Relazione del Consiglio di Amministrazione*) which must accompany the financial statements.

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Although a recent law requiring the independent audit of listed companies' financial statements may do much to improve standards of presentation, the most significant changes are likely to follow the adoption of EEC directives on accounting matters and generally from the adoption of foreign practices.

A list of Italian accounting terms, indicating the items that must be shown separately in the financial statements of every business enterprise, appears later in this chapter. Small businesses (those with turnover of less than Lit.180 million a year) may follow simplified rules.

Publication Requirements

Annual financial statements (comprising balance sheet, profit and loss account, directors' report, and statutory auditors' report) must be made available to shareholders of a corporation or members of a limited company at its registered office at least 15 days before the annual ordinary meeting. Within 30 days after that meeting, a copy of the statements must be filed with the Register of Enterprises, together with a copy of the shareholders' resolution adopting them, and published in the Official Bulletin.

Listed companies will in future be obliged to have an independent audit by qualified accountants as explained later, and the report of the independent auditor must also be filed in the Register of Enterprises and published. Financial statements of listed corporations must be submitted to *CONSOB* also, at least 20 days before the meeting; after they are approved by the shareholders' meeting, *CONSOB* must be notified within 30 days. Half-yearly reports must be prepared by listed corporations, and these must be sent to *CONSOB* and made available to shareholders and statutory auditors.

The directors' report must include the following:

1. Methods adopted in valuing assets and whether these are consistent with those of the previous year. In particular, the principles adopted for depreciation, amortization, and other provisions must be disclosed. If changes in bases have been made, these must be justified and explained, although the effect on results is rarely quantified.
2. Movements in amounts of assets and liabilities.
3. Data concerning personnel and the accrued severance pay provision.
4. Interest charges on long- and medium-term loans and (separately) interest on short-term borrowings, indicating any amounts capitalised.

5. Other capitalised expenditure, such as that on research and development, advertising, marketing, and start-up costs of new plant.
6. Relationship with controlling, controlled, and associated companies.
7. Movements in investments in and current accounts with such related companies.

The Civil Code authorises the imposition of fines for failure to observe any of these requirements.

ACCOUNTING PRINCIPLES AND PRACTICES

Effects of Tax Law

Until recently, the Italian tax system was very complex, and its administration and collection led to endless disputes between taxpayers and the revenue authorities. The authorities tended to disregard any figures of income shown in tax returns prepared from financial accounts and substituted their own ideas concerning taxable profits. These were normally based on standards of profitability predetermined by the tax authorities for each type of business enterprise. In these circumstances protracted discussions and negotiations often took place between the taxpayer and the tax authorities, and there were long delays in the final agreement of tax liabilities. It is therefore hardly surprising that (except for the larger corporations listed on the stock exchange) many enterprises produced different accounts for internal purposes from those submitted to the tax authorities or otherwise made public.

The recent reforms of the tax law described in Chapter 8 and the growth of domestic and foreign investment have made businessmen aware of the problems arising from the production of incomplete financial statements, although mutual distrust between taxpayers and revenue officials still exists. The 1974 tax reforms were designed to stop the raising of arbitrary assessments by the tax authorities. Tax assessments must now be based on the taxpayer's financial accounts, with adjustments as described in Chapter 8. As a corollary, the financial accounts are expected to be true and complete, and heavy penalties are prescribed for understating profits or assets or overstating liabilities. In practice, there is as yet insufficient experience of the new system to know whether financial statements can be relied on to give expected information. It is, however, probably safe to make the following general assumptions:

1. Secret reserves in the narrower sense of undisclosed assets are illegal. However, because of the former prevalence of the practice of keeping

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two (or more) sets of books so that, for example, records of some sales were completely suppressed, it is likely that such reserves still exist.

In the wider sense of excessive provisions also, officially there can be no secret reserves, but where opinion or judgement is involved it is likely that an ultraprudent view will be taken wherever practicable, bearing in mind the heavy sanctions against understatements of profit.

For example, when computing a provision for customer claims or after-sales service expenses, the maximum possible provision is likely to be set up in order to defer tax payment, but not so large a figure that the directors risk prison sentences for filing untrue statements.

2. The former practice of suppressing records of some transactions is likely to be declining as a result of the introduction of value added tax. In order that a buyer can recover VAT paid on his purchases, he will require valid invoices from his suppliers, and the tax authorities are now able to trace that an invoice for a purchase in the buyer's books appears as an invoice for a sale in the seller's books. The risks of blatant tax evasion are now so much greater that fewer responsible businessmen are likely in future to take them. Unfortunately, there is such an administrative backlog in the revenue offices that it may take several years before the new rules are fully understood and enforced.
3. Until accounting standards are agreed upon and accepted by all Italian enterprises, tax law is likely to have a strong influence on the preparation of financial statements. It is not necessary for taxable profits and financial profits to coincide, and tax return forms make specific provision for adjustments and disallowables for tax purposes. However, it is impracticable to adopt the concept that an item can be treated differently for financial statements and for tax purposes. For instance, FIFO cannot be adopted for financial statements and LIFO for tax, or vice versa. On the other hand, while inventory values for tax purposes may not take account of expected falls in realisable values, such falls may quite properly be provided for in the financial statements. However, because it is simpler to follow tax rules, the principles described in Chapter 8 are frequently (if illogically) adopted in preparing financial statements.
4. In spite of the basic requirement of the Civil Code that financial statements must show assets and liabilities at their 'true values,' there is no guarantee that past understatements have all been corrected or that changes in accounting bases are fully revealed and quantified when they take place. Enterprises with foreign participation are likely to pro-

duce realistic financial statements that can be relied upon by both proprietors and tax authorities since, quite apart from ethical considerations and the need for reliable information by absentee owners, any profits to be remitted abroad must, for exchange control purposes, depend on the agreement of the figures by the tax department. Moreover, such enterprises usually attempt to correct any past deficiencies within two or three years of the introduction of the foreign interest.

Financial Statements for Proprietors

The following paragraphs deal with practices adopted in preparing accounts for submission to shareholders or other proprietors and not necessarily with those to be followed for tax purposes. Rules for the computation of taxable profits are described in Chapter 8, and while the trend is towards the adoption of tax rules in many cases, some differences will probably always remain.

When reporting to foreign proprietors, it is the custom of any international accounting firm involved to disclose separately any adjustments required to the Italian accounts in order, for example, that they may conform with group accounting principles.

General Principles. Traditional customs, the influence of 'sound business practices' to assure the security of the business, and the influence of tax law have all tended to make Italian financial statements conservative in outlook. Apart from the very broad rules set out in the Civil Code generally prescribing cost or lower realisable value, no official guidance is yet available that might lead to the adoption of acceptable accounting standards in striking a true profit. The proposed introduction of audits by independent and qualified auditors is currently giving the accounting profession in Italy an excellent opportunity to provide a lead in this direction. Although in the past, bases of valuation of assets and liabilities were rarely described in financial statements, recent modifications of the Civil Code now require that these must be disclosed in the directors' report, and the effects of changes in valuation methods on accounting principles must be quantified. Despite this, there is little emphasis on consistency of presentation in Italy. Prospective purchasers of interests in Italian enterprises will appreciate that the fullest information would have to be obtained from the proprietors and that reliance cannot necessarily yet be placed on published financial statements.

Inventories. These are normally valued at the lower of cost or net realisable value. The basis of valuation must be disclosed in the balance sheet or accompanying report. It is common practice to be conservative in establish-

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ing net realisable value. Cost is often arrived at by the LIFO method because this is generally required for tax purposes. The methods of applying overheads to inventory vary widely, but general expenses and interest charges must not be included.

Fixed Assets and Depreciation. Fixed assets are generally stated at cost, although several laws have been passed permitting upward revaluations to compensate for inflation. The latest of these laws, passed in 1975, has been used by some taxpayers to regularise their official accounts by introducing assets not previously recorded therein. In some instances revaluations are partly taxable, and this probably explains why few businesses have adopted the practice; only on three occasions since World War II (in 1946, 1952, and 1975) have companies been able to disclose their secret reserves without tax liability, and even then this was on condition that these reserves not be distributed.

Cost includes installation expenses and often also any financing expense during construction. Extraordinary expenditure on repairs and maintenance is usually capitalised also and is then amortised at normal depreciation rates. Investment incentive cash grants are recorded in a variety of ways. Some enterprises credit them against costs, thereby reducing future depreciation charges, while others credit them to reserves, or directly to income, or include them with liabilities, in these cases calculating depreciation on gross costs.

Since depreciation must be charged in the books in order to be allowable for tax purposes, the rates adopted are normally the highest allowed by the tax authorities. Where accelerated depreciation is claimed for tax purposes, an excessive charge will consequently appear in the financial statements prepared for shareholders or other proprietors.

On the other hand, when profits are insufficient, depreciation charges may be reduced below what would normally be required to write off the assets concerned over their useful lives. However, the reduction is not usually to less than half the maximum rates permitted for tax purposes, as any further reduction is not generally tax deductible when subsequently charged. Variations in the bases of depreciation charges should in theory be drawn to shareholders' attention, for example, in the directors' report.

Accumulated depreciation is shown on the liabilities side of the balance sheet.

Goodwill and Other Intangibles. Goodwill may be recorded only when purchased. Other intangibles (such as patents, trademarks, research and development) must not be valued above acquisition or in-house cost. Intan-

gibles must be written off over their estimated reasonable lives as determined by the board of directors and approved by the board of statutory auditors. In practice, the amounts written off patents and trademarks are sometimes fairly arbitrary. Preliminary expenses must be written off over five years.

Investments. This category includes securities of controlled and associated companies held for trade purposes and also marketable securities, both equity and fixed-interest. 'Controlled' companies (*società controllate*) are those in which, either directly or indirectly, a majority of the shares or quotas are held, or control is effectively exercised. 'Associated' companies (*società collegate*) are those in which more than one-tenth of the shares or quotas are owned or more than one-twentieth if they are listed on a stock exchange. Investments listed on a stock exchange must be shown separately from those that are not.

Both listed and unlisted investments must be valued by the directors conservatively and the valuations approved by the board of statutory auditors. Due consideration must be given to the trend in market value when valuing listed investments; for unlisted shares and all other investments, valuations may not be higher than the net equity of each holding as shown in its latest approved financial statements.

In practice, therefore, investments may be valued at the lower of cost or market or revalued upwards to market provided the revaluations represent the market trend for listed companies or the net equity derived from the latest approved financial statements for other investments.

A company's own shares that have been repurchased must be shown separately.

Consolidation Practices. It is not customary to publish consolidated statements, although these are sometimes prepared for management purposes. Few companies account for investments in subsidiaries or associates by the equity method, although this is permitted by law. Furthermore, a parent company's dividend income from subsidiaries and associates is not, as a rule, compared with the related net income of such companies.

Financial statements of a parent company must include a list of its investments in controlled and associated companies, with their nominal values and book values as recorded in the parent's books. The financial statements of controlled companies and a resumé of the financial statements of associated companies must be attached.

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Receivables. Although the Civil Code stipulates that accounts receivable shall be stated at net realisable value, tax law allows only a small general provision for doubtful debts, and debts must be proved to be irrecoverable before a provision is allowed as an expense. For simplicity, most enterprises follow the tax rules, although the larger and more sophisticated companies may make higher provisions if these are considered justified.

Amounts due from shareholders for unpaid share capital must be shown separately. Bills (*tratte*) are often discounted with bankers even though not accepted by customers, thus apparently reducing receivables and increasing bank balances. The contingent liabilities resulting from this practice are included in the memorandum accounts at the foot of the balance sheet.

Provisions for Severance Pay. Indemnities payable on termination of employment, for whatever reason, are described in Chapter 4. Because they are deemed to be in the nature of deferred pay they are required to be accrued over each employee's period of service. Factors in the calculation are current wage or salary levels, status, and length of service; provision is rarely made for the effect of any estimated future pay increases. This provision is largely a long-term liability in normal circumstances.

Employee pension schemes are not usual, and pension provisions in the employing company's balance sheet are rarely found.

Taxation. The amount charged in the profit and loss account by all but the largest companies is normally the tax paid in the year and not the tax due on the profit for the year. This is because Italian companies, at least in the past, have been reluctant to prejudice their negotiations with the tax authorities by making any provision before liability is agreed. It is possible that when businessmen have had more experience of the tax reforms of recent years and protracted negotiations are no longer a feature of tax assessments, they may be more prepared to provide for current tax liabilities in their financial statements. Large listed companies would normally provide for all taxes payable on the profits shown, and this is generally recognised as the better practice. Provisions for deferred tax are rarely set up.

Reserves. A legal reserve must be maintained as described in Chapter 6. This reserve is not distributable, although it may be used to meet losses, in which case it must be restored by further annual appropriations in subsequent profitable years. Other reserves are described as 'statutory' if required by the articles of association, or 'extraordinary' in other cases.

Secret reserves, in the wider sense defined earlier in this chapter, although not allowed in theory, are an inevitable outcome of the conservatism prac-

tised by Italian businessmen. On the other hand, disclosed reserves may contain provisions for anticipated liabilities. For example, allocations to reserves may in the past have contained secret provisions for income taxes in view of businessmen's reluctance to disclose tax provisions for the reasons already described. It is therefore necessary to analyse these reserves when examining Italian financial statements, particularly when consolidating them into group accounts in a parent company's home country.

'Retained earnings' or 'unappropriated profit' is a caption that appears rarely in Italian financial statements, all profits being distributed or appropriated to reserves. The profit for the year before appropriations is shown in the balance sheet, not with capital and reserves but at the bottom of the liabilities side between current payables and memorandum liabilities. The proposed appropriation is normally shown in the directors' report.

Mergers. The pooling-of-interests method of accounting for a merger by share exchange is not often found, most mergers being treated as a purchase by one company of the other.

Profit and Loss Account. Turnover is disclosed, but a cost-of-sales figure is not. Management remuneration does not have to be disclosed separately; at the annual meeting, shareholders are asked to approve the directors' allocation of net income, not only for dividends and transfers to reserves, but for any distribution (*tantième*) to directors that may be allowed by the articles of association. However, these *tantièmes* should not be read as the equivalent of total directors' remuneration. Exchange differences are accounted for conservatively, provisions for unrealised losses being made even though disallowable for tax. Exceptional and extraordinary items are not always shown separately as such. The tax charge in the profit and loss account may well not show the total tax charge for the year, as already explained. Large and listed companies now generally provide more information than small unquoted ones.

Other Points. Comparative figures are not often provided in the financial statements themselves, although this practice is growing, but changes in asset and liability figures from those of the preceding year must be described in the directors' report. Secured liabilities are disclosed as such. Post-balance sheet events must be referred to in the directors' report, but capital commitments, contingent liabilities, and other descriptive notes provided in some countries are rarely produced in Italy as an integral part of the financial statements. Comments on some of these points are, however, included in the directors' report, and this is increasingly recognised as good practice. If the Civil Code bases of valuation (generally the lower of cost or

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realisable value) are not used, the directors and statutory auditors must justify the reasons, and the financial effects must be quantified.

Inflation Accounting

Revaluations of fixed assets have been allowed on certain occasions as already noted. No other adjustments for inflation are made, however, and neither current cost accounts, supplementary statements, nor narrative comments showing the effects of inflation are published.

AUDIT REQUIREMENTS AND PRACTICES

Legal Requirements

At the time this business study was written, the only requirement for any form of audit was for the appointment of boards of statutory auditors as described in the section on the management of corporations in Chapter 6.

It has not been common practice in Italy to engage the services of a public accounting firm to perform an annual audit, because there were no legal or commercial calls for such a practice. In recent years, however, banks and others in the business community have come to appreciate the advantages of a professional audit. Any discussion of auditing in Italy as far as it affects the vast majority of enterprises therefore revolves around statutory auditing.

Every *SpA* corporation and *Sapa* partnership, and every *Srl* company with a share capital of Lit.1 million or more, must appoint a board of statutory auditors. The qualifications and duties of such officials, and the procedures for appointing and dismissing them, are described in Chapter 6. Even though the statutory audit board of an enterprise with a share capital of Lit.50 million or more may have some experienced accountants among its members, it does not perform the type of audit that would enable it to express an opinion on the fairness of financial statements as this is understood in English-speaking and many other countries. Statutory auditors need not be appointed by *Srl*s with capitals of less than Lit.1 million nor by most partnerships nor by branches.

New Requirements for Listed Companies

Law 136 of March 31, 1975, provides that all Italian corporations listed on a stock exchange must appoint independent qualified auditors in addition to their statutory auditors. This law, which will probably begin to take effect in

1978, and the tax reforms introduced in 1973 and 1974 are the most far-reaching of the changes concerning professionals and businessmen in Italy in recent years. Because only about 200 companies are involved at present, the new audit law has only restricted effect, but it indicates the trend of government thinking and may prove to be a turning point in Italian commercial history.

The 1975 law is to come into effect in stages. First, the National Commission for Corporations and the Stock Exchange (*CONSOB*) has to publish the rules that are to be followed in future by listed companies and their independent auditors. Within nine months thereafter, an official list of approved independent auditors is to be published. Not more than one year later, companies in the first group listed below must have appointed their independent auditors. The first financial statements to be audited will be those for the second year subsequent to the year in which the auditors are appointed.

For example, assuming *CONSOB* publishes its rules on December 31, 1977, it must have established the list of approved auditors by September 30, 1978. A company in group 1 below would have to appoint a firm of auditors not later than September 30, 1979. If that company's year-end is December 31, as is likely, the auditors will have been appointed in the year to December 31, 1979. The first audited financial statements will then be those for the second year subsequently, namely the year to December 31, 1981.

The four groups into which listed companies have been divided are:

1. All holding companies and all other companies with share capitals of over Lit.50 billion (50 thousand million) — audits required in the first appropriate year of the new rules.
2. All companies with share capitals between Lit.50 billion and Lit.10 billion — the following year.
3. All companies with share capital of less than Lit.10 billion — a year after group 2.
4. Banks, whatever their share capital — a year after group 3.

Qualifications of Independent Audit Firms. The independent auditors must be accounting firms registered with and authorised by *CONSOB*. The register will initially consist of those accounting firms regulated by Law 1966 of 1939 having as their sole object the auditing of financial statements and

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the giving of financial advice and related management services. These, for the most part, are the well-known international accounting groups plus a few Swiss firms.

Any new firm seeking registration will eventually have to satisfy the following requirements:

1. Its activities must be limited to the auditing of financial statements or the giving of financial or management advice (but not taxation or bookkeeping services).
2. A majority of the directors or all the general partners must consist of:
 - a. Accountants who are university graduates (*dottori commercialisti*) or experienced accountants trained in business schools (*ragionieri*). Such accountants must either have been engaged in auditing activities for not less than five years or have passed a special examination set by CONSOB.
 - b. Persons having a diploma equivalent to a certificate (class II) of secondary education (a slightly lower academic standard than that required for category a.) and who have been engaged for not less than five years in professional activities and who have passed the special examination.
3. In the case of corporate bodies, the share capital may not be less than Lit.500 million, and shareholders must be restricted to statutory credit institutions, banks of national interest, or medium-term and long-term finance institutions which operate throughout the whole country. This provision allows the Italian banks to establish their own auditing firms as is often done in Switzerland and Germany.
4. Partnerships must furnish proof that the unlimited partners have personal assets sufficient to meet the firm's liabilities or are covered by guarantees or insurance policies which, in the opinion of CONSOB, constitute adequate security.
5. Foreign-based firms operating in Italy through permanent establishments must prove that they have engaged in the profession of auditing for not less than ten years (although this requirement does not extend to firms legally constituted in other EEC countries). In a foreign firm, the majority of the directors or the general partners must be persons having foreign professional qualifications equivalent to those described in 2. above and who are listed in equivalent foreign professional registers

or whose qualifications are demonstrated in equivalent form. The validity and equivalence of qualifications and of listing in professional registers is determined by *CONSOB*.

A firm of auditors will be admitted to the special register when *CONSOB* is satisfied that the requirements of the law are met, after an assessment of the independence, organisation, and technical adequacy of the firm concerned. Moreover, all registered firms of auditors will be supervised by *CONSOB* in order to ensure that they remain independent and technically adequate. A firm of auditors may be struck off the register if it commits a serious breach of its duties.

Duties of Independent Auditors. The independent audit firm must ensure that proper books and accounts have been kept, that the balance sheet and profit and loss account properly reflect the entries in the books of account, and that shareholders' interests have been accounted for in accordance with the provisions of the Civil Code.

Provided that the balance sheet and profit and loss account properly reflect the entries in the accounting records as verified by the audit procedures performed and are in accordance with the provisions of the Civil Code concerning the content and presentation of balance sheets and profit and loss accounts, and provided that the company's transactions are correctly reflected in the books of account in accordance with proper accounting principles, the independent audit firm must signify its confirmation thereof by attaching an appropriate report signed by one of its legal representatives. The audit procedures performed, together with the names of the field and supervisory staff concerned and the remuneration due to the independent firm, must be recorded in a register to be kept by the audited company at its registered office.

Another duty of the independent auditors is to express an opinion in the case of a capital increase or merger on the fairness of the issue price or exchange ratio of the shares concerned.

Relationship with Statutory Auditors. Listed companies with independent auditors will continue to have boards of statutory auditors with duties broadly unchanged, and the independent auditors must inform the statutory auditors of any matters which they deem require censuring of the directors.

Audit Standards

Statutory Auditors. The duties of statutory auditors are prescribed in the Civil Code, but auditing procedures are not mentioned. If the implicit and

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explicit requirements of the Civil Code were carried out in full, a reasonably thorough audit would have to be performed. Generally, however, the statutory auditors merely meet quarterly as required, examine cash and securities, and record the results of their examination in the minute book maintained for their meetings.

It is not common practice for statutory auditors to carry out such procedures as a review of the system of internal control, confirmation of bank balances, independent confirmation of receivables and payables, observation of physical inventories, or review of post-balance sheet events.

An independent audit firm may allow its members to be appointed to a statutory audit board, but normally only if a professional audit is undertaken.

Independent Audit Firms. No comments can be made on the standards adopted by the independent audit firms to be authorised by *CONSOB*, as the first required audits have not yet taken place. Since most of these firms are initially to be the Italian representatives of the large international accounting groups, it is likely that their practices and standards will compare with generally accepted standards in North America, the United Kingdom, and other countries with advanced auditing professions.

The draft financial statements and directors' report must be presented to the independent auditors not less than 45 days before the general meeting, which allows adequate time for printing and for notice of the meeting (15 days) to be given to shareholders. Professional committees were in the process of defining acceptable auditing standards when this study was being written.

Audit Reports

Statutory Auditors. Because of the lack of detailed auditing, the statutory auditors' report is usually confined to stating that the financial statements are in conformity with legal requirements and corporate statutes. If the broad principles of valuation set out in the Civil Code have not been followed in the financial statements, the directors and the statutory auditors are required to disclose and justify each such case in their reports to shareholders, although without necessarily quantifying the effect of the change. They are not required to disclose such matters as contingent liabilities and profit distribution restrictions however, so that such information is rarely given.

Independent Audit Firms and Others. No standard wording for the independent audit firms' reports on listed companies' statements has yet evolved. The March 1975 law requires the independent auditors to 'certify' the financial statements by attaching an 'appropriate report.' If an audit certificate cannot be issued, the report must explain the reasons, and the independent auditors must notify *CONSOB* immediately.

On the comparatively few occasions in the past when a public accounting firm has been requested to carry out an audit, its report has usually referred to such matters as consistency and fair presentation. An accounting firm would not normally be prepared to issue a report on any financial statements that did not comply with accepted international practices, but would report confidentially to its client what it considered to be the true position.

Changing Auditors

Procedures on a change of statutory auditors have been described in Chapter 6.

Independent audit firms are to be appointed by the shareholders in general meeting for a period of three years. They will be eligible for reappointment for two more periods of three years, but thereafter may not be reappointed for a further five years. This rule is apparently designed to stimulate the growth of new auditing firms. The shareholders will be able to terminate an appointment even before a three-year period is complete, if there are adequate reasons for doing so, but in the same resolution they will be obliged to appoint a new firm. The dismissed auditors will have the right to appeal to *CONSOB*, which may override the dismissal. Professional practices requiring a new independent audit firm to notify the former firm before accepting appointment have not yet developed.

PROFESSIONAL ACCOUNTING AND AUDITING ORGANISATIONS

Although an Italian, Luca Pacioli, wrote a book in 1496 that contained the first clear exposition of the double-entry system, and the world's first accounting association (*Collegio dei Raxonati*) was established in Venice in 1581, Italy's accounting profession today is less developed than that of many countries.

There are two categories of recognised professional accountants: the Doctor of Commerce (*Dottore Commercialista*) and the Accountant and Commercial Expert (*Ragioniere e Perito Commerciale*).

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Doctor of Commerce

An accountant in this category is a university graduate who has studied economics, accounting, banking, and law. He must have passed oral and written examinations and have completed a thesis on an approved subject. Thereafter the graduate must pass a state-controlled examination in order to join the professional body, the Order of Doctors of Commerce (*Ordine dei Dottori Commercialisti*). No practical professional experience is required before joining the Order, so the state examination can be taken immediately after obtaining the university degree. A member of the Order must be a citizen of Italy or of another country that grants reciprocal rights. The Order is responsible for such matters as membership rules and professional rights. Members are divided into two categories — those who are in public practice and those who are not. Unlike the professional bodies in some other countries, the Order has not yet published any official code of ethics or recommendations on accounting principles or audit standards. It is supervised by the Ministry of Justice in accordance with a law of 1953. To remain a member of his profession, a *Dottore Commercialista* cannot engage in a trade for his own account or as an employee of another party and cannot engage in certain other occupations (such as notary public, clergyman, journalist, exchange agent, public service contractor, or tax collector). There are currently about 15,000 *Dottori*, about half being in public practice.

Accountant and Commercial Expert

Although the educational requirements for an Accountant and Commercial Expert are lower than those for a Doctor of Commerce, the law does not distinguish between the two categories in the practice of their profession.

The designation *Ragioniere* is awarded to any accountant who obtains a diploma from a business school whose course of study includes accounting, mathematics, and law and who passes a state-controlled examination. The diploma by itself does not entitle the holder to membership in the Accountant's Association (*Collegio dei Ragionieri*). This is obtained only after two years' practical experience in the office of a *Dottore Commercialista* or *Ragioniere* engaged in public practice and after passing written and oral examinations on tax and accounting matters and the provisions of the Civil Code. The Accountants' Association is a professional body with functions and responsibilities similar to those of the Order of Doctors of Commerce described above. Of its 7,000 or so members, nearly all are in public practice.

Register of Official Examiners

Both categories of accountants, and other appropriate businessmen, may be members of the Register of Official Examiners of Accounts (*Ruolo dei*

Revisori Ufficiali dei Conti) from which certain statutory auditors must be appointed (see Chapter 6). To be listed in this register, applicants must be of Italian nationality and have had at least five years' service as an active statutory auditor or as a director or administrative or accounting officer of a corporation with a capital of at least Lit.50 million or have satisfactorily performed similar duties. Experience of examining and reporting on financial statements as known in countries with advanced auditing professions is not, however, necessary.

The requirement of five years' service is reduced for members of the professional organisations and increased for others, as follows:

1. For *Dottori Commercialisti* — reduced to three years for those who have been members of the *Ordine* for five years.
2. For *Ragionieri* — reduced to four years for those who have been members of the *Collegio* for six years.
3. For all others — increased to ten years.

If the activities of the independent audit firms approved by *CONSOB* are in due course extended to unlisted companies, the importance of the Register of Official Examiners is likely to decline. In any case, the professional recognition accorded to an accountant or accounting firm in Italy is based more on earned reputation than on legal position.

Independence

A statutory auditor may have a financial interest in the company he is examining, although he may not be a director or employee of it or closely related to any of its employees. However, the Civil Code places some managerial responsibility on the statutory auditor which is not compatible with the functions of an independent auditor as understood in many other countries. For example:

1. Statutory auditors must call shareholders' meetings should all the directors vacate office, and in the interim they would manage the company.
2. The chairman of the statutory audit board is normally required to sign the company's income tax returns, which incorporate copies of its official financial statements.
3. A statutory auditor must fulfill his duties with the diligence of an agent, is responsible for the truthfulness of his statements, and must keep

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secret the facts and documents of which he has knowledge by reason of his office. The statutory auditors are jointly liable with directors for the latter's acts or omissions, provided no injury would have occurred if the statutory auditors had exercised due vigilance.

Audit firms authorised as a result of the 1975 reform law are not eligible to act as independent auditors of a company if there subsist any conflicts of interest with the company concerned. These can arise by virtue of shareholdings or contractual relationships (for example, loans by the company to the auditors' employees) or if the firm's partners, directors, statutory auditors, or chief executive officers have certain specific links with the company or with the directors, statutory auditors, or chief executive officers of the company or its holding company, if any.

Independent audit firms are not able to provide bookkeeping services, for which specialist firms must be employed, although they may engage in company valuations and the design of accounting and costing systems.

Dottori Commercialisti, *Ragionieri*, and members of other professions requiring admission to professional registers who are partners, directors, or employees of firms of independent auditors listed on the *CONSOB* register may not engage in professional activities other than auditing and the provision of financial and management advice.

In other accounting firms, both *Dottori Commercialisti* and *Ragionieri* offer a wide variety of services, including tax services and advice.

The organisation of accounting and auditing firms is governed by Law 1966 of 1939 entitled 'Regulation of Fiduciary and Auditing Firms.' Under this law, accountants may organise in any business form and may provide other services of the type common in other countries except that, as indicated above, independent audit firms and their personnel may deal only with the audit of financial statements or the provision of financial or management advice. However, certain accounting services may not be provided by partnerships or companies; for example, only an individual may act as a statutory auditor or an administrator in bankruptcy. This is one reason why most accounting services in Italy are at present provided by individuals. A few large accounting firms have offices in Italy, some being members of international accounting groups. The international firms, like the specifically Italian ones, are regulated by the 1939 law.

Other Professional Matters

The fees of *Dottori Commercialisti* and *Ragionieri* are mainly fixed by law. They may be related to assets, income, paid-in capital, the significance of

accounts verified, or other criteria. The remuneration of independent audit firms is fixed, in accordance with general rules still to be determined by CONSOB, by the shareholders' meeting or, failing that, by CONSOB itself.

Any accountant who signs an audit certificate under the 1975 law and any of his employees who performs the audit are jointly liable with the firm of independent auditors concerned for any damage suffered by the company or by third parties as a result of breaches of duty or unlawful actions committed by the auditors in the performance of their audit. Other penalties, including imprisonment, are provided in case of falsehood in certification or abuse or disclosure of privileged information.

BOOKS AND RECORDS

Legal Requirements

All businesses must maintain a journal (*libro giornale*), which lists daily transactions in chronological order, and a balance book (*libro inventari*), which contains each year's closing trial balance. Companies may use any bookkeeping system they choose, but must maintain registers of shareholders and bondholders and minute books of meetings of shareholders, directors, executive committees (if any), and statutory auditors.

All these books must have consecutively prenumbered pages and must be stamped when first used, and then annually, at the court where the Register of Enterprises is kept or by a public notary. The asset register, inventory, and commission records described below must also be stamped on first use.

Incoming correspondence and copies of outgoing correspondence and invoices must be retained. Labour and social insurance laws require that payroll and personnel registers be maintained.

Tax regulations require the maintenance of various records, the chief ones being:

1. Record books prescribed by the value added tax law (see Chapter 8).
2. Such books and records as are necessary to demonstrate clearly the taxpayer's assets, liabilities, income, and expenses.
3. Record of depreciable assets and annual and accumulated depreciation.

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4. A detailed inventory book, which lists movements of quantities of goods by class and category.
5. Individual chronological records of all commissions, fees, interest, and bonuses paid to third parties.
6. A chart of accounts containing an explanation of codes used and valuation bases adopted, especially if the records are kept on a computer.

These are the more commonly required books and records, and the list is not meant to be exhaustive. All books, documents, and supporting records, including those of dissolved companies, must be kept for at least ten years. The law requires that in order to constitute acceptable evidence, the books must be written in the Italian language, and books and original vouchers alike must be kept in Italy. Thus if a parent company's computer in another country is used to maintain the Italian subsidiary's accounting records, printouts that comply with Italian law must be returned regularly to Italy.

Literal compliance with the requirement that all transactions be entered in the journal would be so impracticable that the tendency is to ignore it, and in practice summary entries are usually made only periodically. However, stamped auxiliary records are kept that are more appropriate for practical purposes and at the same time meet the legal requirements.

The bankruptcy of a company that has not kept its records in accordance with the law could be considered to be the result of fraud, and its directors could be held personally liable for its debts and imprisoned. Other penalties resulting from the maintenance of inaccurate accounting records are described in Chapter 8. Moreover, the official books and records form the bases on which the rights of the company and its shareholders, tax declarations, tax appeals, liquidations, and dividends and other profit remittances depend. Following the introduction of value added tax and the institution of heavier penalties for suppressing profits, there is now a movement toward reform, and a foreign investor would be unwise to be a party to any tax evasion. The former practice of keeping 'black books' is likely therefore to become much less prevalent.

Management Accounts

In the larger companies, internal accounts for management purposes are widely used, and a growing number of enterprises employ accountants with experience in such sophisticated procedures as standard costing and budgetary controls. However, because of the secrecy often sought by

proprietors, even senior operating managers are not always given realistic financial information or profit targets, and smaller companies are less likely to produce much information for management.

SPECIMEN FINANCIAL STATEMENTS

To assist readers of Italian financial statements, some terms often used, together with translations into English, are presented on the following pages. The terms exemplify the disclosure requirements of the Civil Code.

Some large corporations with foreign shareholders produce versions or summaries of their published accounts in English or other languages as well as in Italian.

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TERMS USED IN ITALIAN FINANCIAL STATEMENTS

BILANCIO AL . . .

Attivo

Crediti verso i soci per versamenti
ancora dovuti
Terreni e fabbricati
Macchinari e impianti
Mobili e arredi
Spese differite
Brevetti
Avviamento
Rimanenze finali
Cassa
Conto corrente postale
Banche c/correnti
Titoli

Investimenti

Depositi cauzionali
Azioni sociali

Clienti
Altri crediti
Ratei e risconti attivi
Crediti verso società controllate
e collegate
Conti d'ordine

Passivo

Capitale sociale
Riserva legale
Sovraprezzo azioni

Altre riserve
Fondo ammortamento
Fondo indennità fine servizio

Riserva per crediti dubbi
Fondo svalutazione magazzino
Mutui ipotecari
Mutui a lungo termine
Obbligazioni emesse
Banche conti correnti passivi
Debiti verso società controllate
e collegate
Fornitori
Fondo imposte
Ratei e risconti passivi
Altri creditori
Utile d'esercizio

Conti d'ordine

BALANCE SHEET AT . . .

Assets

Share subscriptions owing by
shareholders
Land and buildings
Machinery and equipment
Furniture and fixtures
Deferred charges
Patents
Goodwill
Inventories
Cash on hand
Postal checking account
Cash at bank
Marketable securities (shares and
bonds)
Investments in controlled and
associated companies
Guarantee deposits
Treasury stock (repurchased share
capital)
Accounts receivable — trade
Other receivables
Prepayments and deferrals
Receivables from controlled and
associated companies
Memorandum accounts

Liabilities

Share capital
Legal reserve
Share premium account (paid-
in surplus)
Other reserves
Accumulated depreciation
Provision for severance pay
and seniority allowances
Provision for doubtful accounts
Provision for inventory losses
Mortgage loans
Other long-term loans
Bonds issued
Bank overdrafts
Intercompany payables
Trade accounts payable
Accrued taxes
Accrued expenses
Other payables
Profit for the year (before
appropriations)
Memorandum accounts

TERMS USED IN ITALIAN FINANCIAL STATEMENTS (cont.)

CONTO PROFITTI E PERDITE DELL' ESERCIZIO

Perdite

Esistenze iniziali di materie
prime - semilavorati, prodotti
riniti e merci
Acquisti di materie prime, semi-
lavorati, prodotti finiti e merci
Spese per prestazioni di lavoro
subordinato e relativi contributi
Spese per prestazioni di servizi
Imposte e tasse (con separata indi-
cazione di quelle relative a
precedenti esercizi)
Interessi e gli altri oneri sui
debiti obbligazionari
Interessi sui debiti verso società
controllate e collegate
Interessi sui debiti verso banche
Interessi sugli altri debiti
Sconti e gli altri oneri finanziari

Ammortamenti per gruppi omogenei
di beni

Accantonamenti ai fondi di liquidazione
o di previdenza
Accantonamenti ai fondi di copertura
del rischio di svalutazione dei titoli,
dei crediti e di altre categorie di beni

Accantonamenti per oneri fiscali e
altri oneri specifici
Minusvalenze risultanti dalle
valutazioni di bilancio relative alle
varie categorie di beni
Spese e le perdite diverse da quelle
indicate nelle lettere precedenti e
le sopravvenienze passive

PROFIT AND LOSS ACCOUNT FOR THE YEAR

Expenses and Losses

Opening balances of raw materials,
semi-finished, finished, and
purchased inventories
Purchases of raw materials, semi-
finished, and finished goods
Payroll and related costs

Cost of services received
Taxes paid (with separate
disclosures of amounts
relating to prior years)
Interest on bonds and related
expenses
Interest on intercompany payables

Interest on bank loans
Interest on other payables
Discounts and other financial
charges
Provision for depreciation and
amortisation (analysed into
appropriate categories)
Provision for severance pay

Provision for doubtful accounts
and for possible decreases in
value of investments and other
assets
Provision for taxes and other
specific liabilities
Write-downs for permanent
decline in value of assets

Other expenses

(continued)

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TERMS USED IN ITALIAN FINANCIAL STATEMENTS *(cont.)*

CONTO PROFITTI E PERDITE DELL' ESERCIZIO *(continua)*

Profitti

Ricavi delle vendite e delle prestazioni raggruppati per categorie omogenee

Proventi degli investimenti immobiliari

Dividendi delle partecipazioni in società controllate e collegate

Dividendi delle partecipazioni in altre società

Interessi dei titoli a reddito fisso

Interessi dei crediti verso banche

Interessi dei crediti verso società controllate e collegate

Interessi dei crediti verso la clientela

Interessi di altri crediti

Plusvalenze derivanti dall' alienazione di beni (non computabili tra i ricavi di cui al minimo)

Incrementi degli impianti e di altri beni per lavori interni

Proventi e i ricavi diversi da quelli indicati nelle lettere precedenti e le sopravvenienze attive

Rimanenze finali di materie prime semilavorati, prodotti finiti e merci

Other terms sometimes used:

Utile lordo

Spese commerciali

Ammortamenti

Spese generali

Utile d'esercizio

Quota del periodo

PROFIT AND LOSS ACCOUNT FOR THE YEAR *(continued)*

Income and Profits

Sales of goods and services (classified into appropriate categories)

Income from property (real estate)

Dividends received from controlled and associated companies

Other dividends received

Interest from fixed interest securities

Bank interest received

Interest on intercompany receivables

Interest on trade receivables

Interest on other receivables

Gains on sale or disposal of fixed assets

Internal costs capitalised

Other income

Closing balances of inventories of raw materials, work in process, finished goods

Gross profit

Selling expenses

Depreciation

General expenses

Profit for year

Provision made in year (for example for depreciation or other expense)



- | | |
|---------------------------------------|---------------------------------|
| ■ SUMMARY OF TAX STRUCTURE | ■ VALUE ADDED TAX |
| ■ CORPORATE TAXATION | ■ OTHER TAXES |
| ■ TAXATION OF OTHER BUSINESS ENTITIES | ■ SAN MARINO, VATICAN CITY, AND |
| ■ TAXATION OF INDIVIDUALS | CAMPIONE |
| ■ WITHHOLDING TAXES | ■ SPECIMEN TAX COMPUTATIONS |
| ■ DOUBLE TAXATION AGREEMENTS | |

SUMMARY OF TAX STRUCTURE

Italy's principal taxes on income are corporate income tax (*IRPEG*), personal income tax (*IRPEF*), and local income tax (*ILOR*). In addition there are a value added tax (*IVA*); a tax on property appreciation (*INVIM*); stamp and registration taxes; estate, inheritance, and gift taxes; and other minor imposts. Some taxes are collected at source by a system of withholding taxes. No tax is levied on net wealth. Customs and excise duties are described in Chapter 3.

Sources of Legislation

The present system of income taxation in Italy derives from a series of presidential decrees promulgated during 1973, which completely reformed the Italian tax system. Italian income tax law is now based on the following decrees, all dated September 29, 1973:

- No. 597 — creation of and rules relating to the personal income tax (*IRPEF*).
- No. 598 — creation of and rules relating to the corporate income tax (*IRPEG*).
- No. 599 — creation of and rules relating to the local income tax (*ILOR*).
- No. 600 — general rules concerning the assessment of income taxes.
- No. 601 — rules governing tax relief and benefits.
- No. 602 — provisions concerning the collection of income taxes.
- No. 605 — provisions relating to the tax records office and taxpayers' code numbers.

Taxation in Italy

Although these decrees are legally in force, the tax administration has not yet been able to apply the new system to the assessment and collection of income taxes for the years 1974 and after. This is due to the huge arrears of work in all tax offices where cases relating to years prior to the reform still have to be negotiated.

The creation of and rules relating to taxes other than on income are based on the following decrees, all dated October 26, 1972:

- No. 633 — value added tax (*IVA*).
- No. 634 — registration tax.
- No. 637 — estate, inheritance, and gift taxes.
- No. 641 — governmental concession tax.
- No. 642 — stamp tax.
- No. 643 — tax on property appreciation (*INVM*).

Decree No. 636 of the same date revised the rules for appeal procedures for all income and other taxes.

Several subsequent laws concerning both income and other taxes have modified these basic decrees.

A major characteristic of the 1972/73 Italian tax reforms was the simplification of the tax system. The myriad taxes previously in force were reduced to three basic taxes, and the former practice of levying 'collection taxes' on the taxes themselves was eliminated. As a result, taxes have been rendered considerably more intelligible and their collection greatly simplified.

The new regulations for determining taxable income require objectivity, which should be in the interest of both taxpayer and tax authority. The regulations emphasise the accounting and bookkeeping obligations of all business enterprises and establish that the financial statements adopted by the proprietors shall be *prima facie* binding upon the tax authorities. As a result of the tax reform, the tax authorities are no longer permitted to make inductive assessments in complete disregard of the financial results shown in the taxpayer's accounting records. As a corollary, the penalties imposed on taxpayers for producing inaccurate financial statements have been considerably increased.

As a transitional measure, a 'tax amnesty' (*condono*) was decreed on November 5, 1973, with the purpose of expediting the work backlog in the tax offices and of allowing taxpayers a fresh start as of 1974. For each taxpayer, the liability for any years prior to 1974 still to be assessed was defined automatically by a series of detailed compromise calculations based on declared income, profits, or losses.

The general characteristics of the *condono* were:

- it was applied only at the taxpayer's own request;
- it was valid for both direct and indirect taxes;
- no fines or penal surtaxes were applied;
- it encouraged the settlement of all taxes prior to 1974.

Definition of Territory

Italian tax law applies to the entire Republic of Italy with the exception of the small territory of Campione d'Italia, within Switzerland. The two independent states within the Italian peninsula, San Marino and the Vatican City, have their own separate taxation systems. These three territories are described later in this chapter.

Administration of Tax Laws

The government department responsible for administering tax law is the Ministry of Finance, which collects the taxes from corporations and individuals.

For the purpose of assessment and collection of income taxes, Italy is divided into tax districts based on the communes. Each district has a tax office responsible for assessing and reconciling the tax liabilities of companies and individuals whose legal addresses are within its district. Collection of tax is organised through separate collection offices or through paid collection agents such as banks. The registration offices of the communes are responsible for collecting some minor taxes.

The Tax Commission is a body responsible for handling appeals against tax assessments, similar to the tax courts found elsewhere.

CORPORATE TAXATION

Entities which are subject to the corporate income tax (*IRPEG*) and the local income tax (*ILOR*) are stock corporations, limited liability companies, partnerships limited by shares, foreign partnerships, mutual insurance com-

Taxation in Italy

panies, and similar associations having as their exclusive or main purpose the exercise of business activities. In this chapter, unless the context requires otherwise, all these entities are described as 'companies.'

Resident companies are subject to corporate income tax on their worldwide income. They are also subject to local income tax on their worldwide income with the exception of profits earned outside Italy attributable to a foreign permanent establishment.

Companies are regarded as resident in Italy for income tax purposes if they are incorporated in Italy or if they have their administrative headquarters or principal business activity within Italy.

Nonresident companies, that is, those incorporated outside Italy and not having their administrative headquarters or their principal business activity within Italy, are taxable only on income derived from Italy.

There is no system for imputing taxation of companies to shareholders, and shareholders are liable to personal income tax (*IRPEF*) on any dividends received.

There are no special rules for 'close' companies (those controlled by a small number of individuals), to ensure distribution of profit to shareholders, as there are, for example, in Japan, UK, or USA.

Taxable Profits

The profits disclosed by the official financial statements are adjusted in arriving at taxable profits to allow for exempt profits, disallowable expenditure, special deductions, and losses brought forward. The more important adjustments are described below.

Exempt Income. The following items are excluded from taxable profits:

1. Income which has been subject to a final or definitive withholding tax at source (page 156).
2. Incentive grants to companies operating in certain depressed areas, provided these are credited to a special reserve or used to offset losses.
3. Premiums and income from public (state and commune) bonds, with certain exceptions.

Dividends received from other Italian companies are not exempted unless they have been subject to a final or definitive withholding tax.

Rents Receivable. Actual net income from rents received from real estate less any related expenses is replaced by the higher of either the cadastral income of the property or the net rent received as adjusted for tax purposes. The cadastral income is the notional rent attributable to the real estate based on its value in 1939 as updated by a government coefficient. The net rent received for tax purposes is in practice the gross rent less a deduction allowed by the tax office of 25% to cover expenses if the property is residential or 33⅓% if it is commercial or industrial.

Valuation of Inventory. A form of the LIFO method of valuing inventory must normally be followed, whereby at the end of the first trading year inventory is valued at the average cost of all purchases in that year. In each subsequent year any increase in the quantity of inventory at the year-end is valued at the average cost of all purchases in that year.

However, if in a subsequent year there is a decrease in the year-end inventory, the decrease must be set against any increases in the value of stock in previous years, starting with the latest year.

The following example illustrates this method of calculation:

| Year | Inventory at Year-End (units) | Avg. Cost of Purchases in Year per Unit (Lit.000) | Value of Inventory at Beginning of Year (Lit.000) | Increase / (Decrease) in Year-End Inventory (units) | Value of Increase / (Decrease) in Year-End Inventory (Lit.000) | Value of Inventory at Year-End (Lit.000) |
|------|-------------------------------|---|---|---|--|--|
| 1 | 1,000 | 1.0 | — | 1,000 | 1,000 (1,000 × 1.0) | 1,000 |
| 2 | 1,500 | 1.3 | 1,000 | 500 | 650 (500 × 1.3) | 1,650 |
| 3 | 1,700 | 1.6 | 1,650 | 200 | 320 (200 × 1.6) | 1,970 |
| 4 | 1,400 | 1.7 | 1,970 | (300) | (450) (200 × 1.6 + 100 × 1.3) | 1,520 |

This method of valuing inventory may be modified where the replacement cost of the year-end inventory is lower than the value ascertained as above. In this situation, the lower replacement cost is used in arriving at taxable profits. Replacement cost is determined by applying the average cost of all purchases during the last quarter of the year to the total quantities held at the year-end.

Companies may elect to use any other acceptable method of inventory valuation (for example, FIFO or average cost). Since in times of rising

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prices a change to another basis would produce a higher taxable profit, it is likely that the tax office would approve the change. Any such change must be specifically agreed upon with the tax office and would become effective from the beginning of the following year. The new basis of valuation must thereafter be used consistently.

No deductions are allowed for general provisions for anticipated falls in realisable values or for slow-moving or obsolete items. The tax authorities may require proof of any reduction in the value of inventory for items scrapped.

Work in progress is valued at cost including direct overheads but excluding interest and general expenses. If any part of work in progress relates to a contract lasting for more than one year, the profit or loss on the contract is allocated over its life according to a formula based on the estimated final profit or loss on the contract and the work performed to date.

Revaluation of Fixed Assets. Any surplus arising on a revaluation of fixed assets is deemed to be assessable income of the year in which the increase in value is recorded in the accounts. The only exceptions to this rule have been the revaluations permitted to resident companies in accordance with specific laws passed in 1946, 1952, and 1975.

Capital Gains. All capital gains are taken into account in computing corporate income tax, including those realised on the disposal of real estate, even though these are also liable to property appreciation tax (*INVIM*). This tax (described on page 163) is deductible in computing the gain liable to corporate income tax.

However, special provisions exempt a realised capital gain from tax if it is reinvested. In order to qualify for this exemption the gain must be credited to a special reserve in the balance sheet and an equivalent amount must be reinvested in depreciable assets within two years following the end of the year in which the gain is realised. Tax depreciation allowances on the new assets will be based on their cost less an amount equal to the capital gain in the special reserve. Any portion of the gain which has not been reinvested within the following two years must be included in the taxable income of the second year after that in which the gain was realised.

Losses on the disposal of capital assets are treated as allowable expenses for corporate income tax purposes.

Dividends. Dividends received are subject to corporate income tax but not to local income tax. Dividends distributed by resident companies to Italian

resident recipients are subject to withholding tax. The rate of withholding tax is either 10% or 50%; a recipient company may elect to suffer a 10% withholding tax on account of its corporate income tax liability if the dividends are included in its taxable profits or a 50% final withholding tax in full settlement of its tax liability on dividend income. The election may be varied from year to year according to the company's actual corporate income tax rate.

Dividends paid to nonresident companies are subject to a 30% rate of withholding tax unless a lower rate is permitted by a double taxation agreement. Nonresident companies cannot elect to pay the 10% rate. However, if the nonresident is subject to an income tax on the dividend in his country of residence he may credit such domestic tax against the 30% Italian withholding tax up to a maximum rate of 20% and claim a refund.

An Italian company receiving dividends from abroad that have suffered foreign tax may claim a tax credit, the calculation of which is illustrated on the following page.

There are no special provisions for intergroup dividends, and these are therefore taxed as described above.

Group Taxation. Italian tax law contains no special provision for groups of companies. A company is always treated as an independent entity.

Foreign Income. Where an Italian company's taxable profit includes foreign income, any foreign tax paid as a final tax on that income can be credited within certain limits against the Italian corporate income tax payable in respect of such foreign income.

Tax credit relief is given only when the foreign tax has actually been paid and not when the income arises. The credit must be claimed in the year in which the foreign tax is paid, or it will be lost. The credit is given in the year in which it is claimed, and if it is greater than the Italian tax payable for that year, the taxpayer is entitled to a refund of the excess.

The credit is calculated separately for each foreign country concerned and is not necessarily for the full amount of foreign tax paid. The rate of credit depends on whether or not the foreign country allows reciprocal relief. If the foreign country grants similar relief for income which has suffered Italian tax, Italy gives a credit for the tax of that foreign country up to an amount not exceeding 66⅔% of the Italian tax attributable to the income derived from that particular country. If the other country does not grant a similar relief, the credit is limited to 25% of the Italian tax paid on the income from that country.

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Foreign taxes qualifying for credit are those payable on income including, in the case of dividends, foreign taxes borne on the profits out of which the dividends are paid and foreign withholding taxes. The calculation of the tax credit is illustrated below:

| | Lit.000 | |
|--|---------------|---------------|
| | Income | Amount of Tax |
| Income from Country A (tax credit granted for Italian tax) | 4,000 | 2,000 |
| Income from Country B (no tax credit granted for Italian tax) | <u>2,000</u> | <u>500</u> |
| | 6,000 | <u>2,500</u> |
| Italian source income | <u>26,000</u> | |
| Total income | <u>32,000</u> | |
| Italian tax on total income, e.g., @ 25% | | <u>8,000</u> |
| Italian tax attributable to foreign income: | | |
| Country A (4,000@ 25%) — Lit.1,000 | | |
| Country B (2,000@ 25%) — Lit.500 | | |
| Tax credit: | | |
| Country A: 66⅔% of Lit.1,000 | | 667 |
| Country B: 25% of Lit.500 | | <u>125</u> |
| Total tax credit | | <u>792</u> |

The tax credit cannot exceed the foreign tax paid.

Exchange Profits and Losses. The treatment of exchange profits and losses varies, but in general profits and losses actually realised on normal trading transactions are treated as forming part of a company's taxable profits.

Allowable Deductions

General Rules. In general, all costs and expenses are allowed as deductions in computing taxable profits provided the taxpayer can show that they have been incurred in order to generate taxable income. To qualify as deductible, such costs and expenses must have been paid during the year or be a liability at the end of the year and so recorded in the accounts. However, if total income includes income exempt from tax, any costs and expenses which cannot be specifically attributed to the generating of taxable income may be deducted only in the proportion that taxable income bears to total income.

Depreciation. All fixed assets, with the exception of land, are depreciable for tax purposes. Depreciation deductions commence in the first year in

which the asset is or could have been utilised. To be deductible for tax purposes, depreciation must be recorded in the company's financial books and in a register of depreciable assets.

A newly-formed company is permitted to defer its claim for depreciation until the first year in which sales are made. Other companies also may defer depreciation, but if the amount claimed in any year is less than one-half of the depreciation prescribed by the Ministry of Finance, the difference may not be claimed in a future year unless the lower amount can be shown to be due to abnormally low use of the assets concerned. Depreciation claimed for corporate income tax purposes may not exceed the amount shown in the annual financial statements, but any depreciation charged in the financial statements in excess of amounts permitted by law is disallowed.

The profits on the sale of fixed assets are treated as taxable profits, except that any excess of sale proceeds over original cost is subject to the rules for capital gains.

Calculation of Depreciation. Depreciation is calculated by the straight-line method on cost before deducting any government grants received but after deducting reinvested capital gains. Rates of depreciation have been published in a Ministry of Finance decree, and different rates apply depending not only on the type of asset concerned but also on the taxpayer's trade or industry. The rate prescribed may be exceeded if an asset is used more intensively than is usual for the type of business involved.

The table below shows the rates applicable to assets not specified separately in the decree and is meant only to indicate the range and extent of the rates available; reference must be made to the decree for the actual rates applicable to a particular asset in any given industry.

| Type of Expenditure | Rate % |
|--|--------|
| Buildings | 3 |
| Short-life structures (e.g., sheds or shelters) | 10 |
| Loading, unloading, lifting, and weighing equipment | 7.5 |
| Machinery and miscellaneous equipment (including refrigerators and air-conditioning plant) | 15 |
| Shelving | 10 |
| Soft furnishings (e.g., carpets and curtains) | 15 |
| Security devices including security plate glass | 20 |
| Alarm systems and photographic, cinematographic, and television filming equipment | 30 |
| Internal communication equipment | 25 |
| Furniture and ordinary office machines | 12 |
| Electric and electronic office machines | 18 |
| Motor vehicles and internal transport | 20 |

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Although depreciation is generally calculated by the straight-line method using the rates indicated, accelerated depreciation may be claimed in the first three years of an asset's life, up to a maximum of 15% per year on the original cost. In the fourth and subsequent years, the rates used are those set out in the decree. Assets costing less than Lit.50,000 may be fully written off in the year of purchase.

Amortisation of Intangible Assets. Intangibles are treated as follows:

1. Goodwill, if purchased from a third party, may be amortised at 20% of cost.
2. Patents and know-how may be amortised over the relevant asset's useful life. If no fixed life can be determined, the maximum annual allowance is 20% of cost.
3. Up to 50% of research expenditure is deductible in the period in which it is incurred, the balance being capitalised. If the research concerned is showing positive results in the business, the capitalised amount may be amortised over the period during which the business will benefit. If the research is found to be valueless, the capitalised amount may be written off either in full in the following year or by equal instalments over the next five years.
4. Advertising expenses may be written off entirely when incurred or in equal instalments over three years, starting with the year in which they were incurred.

Intangibles may be recorded only at cost.

Expenses of Setting Up a Business. Formation and organisation expenses, including expenses incurred prior to the commencement of trading, are deductible at any time within the first five years, with a maximum deduction in any one year of 50% (or 20% in the case of interest charges included in such expenses).

Rents Payable. These are deductible provided they are reasonable and are incurred for trade or business purposes.

Interest. The general rule is that interest is deductible when paid. To the extent that total income contains exempt income and income subjected to a definitive withholding tax, a proportion of the interest paid will be disallowed.

The disallowance is computed as follows:

$$\frac{\text{Gross receipts and other business income} \\ \text{excluding exempt income and income} \\ \text{subjected to a definitive withholding tax}}{\text{Gross receipts and all other income}} \times \text{interest paid}$$

Interest paid prior to the receipt of any income is deductible as described above commencing in the year when income is first received. Interest paid on loans to finance the purchase or construction of fixed assets may be capitalised and depreciated as part of cost.

Royalties. Royalties on patents, trademarks, know-how, and similar rights are deductible provided the amounts are reasonable and are computed at arm's length.

When royalties are paid to related companies they are closely scrutinised by the tax authorities, but provided they comply with the arm's-length concept, they are allowed in computing taxable income.

Royalties paid to nonresidents are subject to an effective 14% withholding tax (20% on 70% of the amount paid), subject to the provisions of any relevant tax treaty. The taxation of royalties paid to nonresidents is not clear. The Italian tax authorities argue that royalties are Italian-source income subject to corporate and local income tax and that the withholding tax is only a payment on account. A further complication is that a number of tax treaties with Italy make no reference to local tax. A recipient of royalties from Italy should seek advice on whether an Italian tax return should be made.

Service Fees. Expenses such as management fees, technical advisory or assistance fees, or market service fees are deductible, provided they are reasonable and are computed at arm's length, particularly where payments are made to related companies. Fees paid to nonresident individuals are subject to a 20% withholding tax if the services are performed in Italy.

Directors' Remuneration. Executives' salaries and directors' fees are deductible, but distributions of profits (*tantièmes*) are not. The remuneration of directors who are also shareholders may be restricted.

Taxes. Indirect taxes such as registration tax and stamp duties are deductible for corporate income tax purposes as is nonrefundable value added

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tax. Tax on property appreciation is also deductible. On the other hand, local income tax and foreign income taxes are not deductible for corporate income tax purposes.

Bad and Doubtful Debts. All debts which are irrecoverable at the end of the year may be written off, provided they arose from trade or business. This includes loans for capital purposes as well as normal trading debts.

A general provision of 0.5% of total debts receivable at the year-end may be made each year until the total doubtful debt provision reaches 2%. The provision may then be increased by 0.2% of the total debts receivable each year until it reaches 5%.

Repairs and Maintenance. The costs of repairs, maintenance, modernisation, and alterations are deductible up to a maximum of 5% of the total cost of depreciable assets held at the beginning of the year. Any further costs actually incurred are only deductible in equal instalments over the following five years.

Periodic Overhaul of Ships and Aircraft. Companies operating ships or aircraft may set up a provision for cyclical maintenance and repairs, the maximum sum deductible annually being 5% of the cost as shown in the register of depreciable assets at the beginning of the year. Any excess of the cumulative amount provided over the periodic expenses when incurred must be included in taxable income in that year. Any excess in the expenses incurred over the amounts provided must be claimed as for normal repairs and maintenance.

Social Welfare and Charitable Contributions. The following amounts are deductible:

1. Gifts made to or on behalf of all employees for the specific purposes of education, recreation, or religious or social welfare, provided they do not exceed 0.5% of the amount of the employee payroll as shown in the annual tax returns of the company.
2. Gifts to entities devoted to education, scientific research, recreation, religious or social welfare, not exceeding 2% of taxable income.
3. Gifts to universities, not exceeding 2% of taxable income.
4. Gifts to legal entities in the Mezzogiorno whose activities are wholly involved in scientific research, not exceeding 2% of taxable income. (Items 2, 3, and 4 are additional to each other, not alternative.)

5. Contributions made by employers to the state social security and pension schemes. Companies normally do not operate private pension schemes.

Gifts or charitable contributions for purposes other than those indicated are not deductible.

Travel and Entertainment. Travel or entertainment expenses are deductible provided they are reasonable and are incurred in producing taxable income.

Insurance Premiums. Premiums paid on insurance policies for business purposes and contracted for locally are deductible. Payment of premiums to insurance companies in foreign countries is normally not possible.

Severance Indemnities. Provisions for employees' severance indemnities are deductible provided they are calculated in conformity with the statutory and contractual provisions governing employment.

Tax-Free Reserves and Provisions. Apart from provisions for doubtful debts, periodic overhaul of ships, and severance indemnities as described above, tax law does not allow deduction for any reserves or provisions.

Transactions with Related Persons. The law refers to the concept of 'normal values' of goods and services based on prices in the free market. Normal values, that is, open market values, must be used in determining a taxpayer's taxable income. There are special provisions for reducing the invoiced cost of goods or services supplied to an Italian company to the open market value if lower, where the supplier is nonresident and is either controlled by or controls the Italian company or both companies are under common control.

Treatment of Losses

Carry-Forward and Carry-Back. Tax losses may be carried forward for five years, but may not be carried back. Losses carried forward may be set against future income as determined for corporate income tax purposes, including capital gains, interest, and dividends which have not suffered definitive withholding tax.

Capital losses arising from the disposal of assets are regarded as allowable expenses for corporate income tax purposes and are therefore part of any trading loss.

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There is no rule that losses can only be carried forward against income derived from the same trade, nor is there any restriction on the utilisation of losses following a change in the ownership of a business.

Transfer of Losses between Group Companies. The law recognises neither the transfer of losses from loss-making to profit-making members of the same group of companies, nor any form of consolidated return.

Nonresident Companies

Companies are not resident in Italy if they are neither incorporated nor have their administrative headquarters or principal business activity there.

Nonresident companies include partnerships and business entities of all types, whether or not they have legal status.

Italian Source Income. Nonresident companies are subject to tax in Italy only on income from an Italian source, which includes:

1. Income from business activities carried on through a permanent establishment (see below).
2. Capital gains arising from the liquidation or transfer of businesses within Italy.
3. Income from independent work performed in Italy.
4. Income from real property situated in Italy.
5. Investment income from stocks and shares in Italian companies and from deposits in Italy.
6. Income from speculative or occasional activities in Italy.

These general rules are frequently modified by double taxation agreements.

Permanent Establishment. No precise definition exists of a permanent establishment, and reference must be made to the appropriate double taxation agreements. Broadly, these deem a permanent establishment to exist where there is at least one of the following:

1. A fixed place of business.

2. A construction site existing for a period in excess of twelve months.
3. An agent (other than an independent agent acting in the ordinary course of his business) authorised to transact business and having the power to bind the company.
4. Any other fixed installation having an income-producing character.

An office confined wholly to research, advertising, or purchasing is not normally treated as a permanent establishment. An agent whose activity is limited to transmitting orders or delivering goods from stock maintained in the country does not normally constitute a permanent agency in Italy.

The tax liability of a permanent establishment is the same as that of an Italian incorporated and resident company. No withholding tax is levied, however, when it remits profits to its head office.

The term 'branch' will be used in the following paragraphs for convenience, as the equivalent of the more general and technical term 'permanent establishment.'

Branch or Subsidiary. Although a branch has the advantage of not suffering withholding tax on the remittance of profits to its head office, foreign investors generally prefer to operate through a subsidiary company for several reasons apart from any commercial considerations.

The financial statements of a subsidiary company are treated by the tax authorities as those of any other local company; whereas in the case of a branch, the tax authorities may request the financial statements of its head office.

In both cases the arm's-length concept must be carefully followed, but while charges by a parent company for management services, royalties, and interest on loans are normally deductible within reason, a branch may have more difficulty in obtaining a deduction for such expenses, particularly where interest and royalties are payable to the head office.

A branch cannot be amalgamated with a corporation or limited company, and so growth by merger entails tax disadvantages.

Liquidations and Reorganisations

Liquidations. All capital gains realised during liquidation represent taxable income of the liquidating company; the same applies to deemed gains on

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distributions in specie. The liquidator must file a tax return for the period up to the date on which the resolution to liquidate the company is passed and another for the period to the date of the final liquidation balance sheet. If the liquidation extends beyond the year in which it commences, the liquidator must file annual tax returns.

Liquidation proceeds received by a shareholder in excess of the original amount of his investment are liable to income tax.

Mergers. A merger of two or more companies does not result for tax purposes in a realisation or distribution of capital gains by those companies or their shareholders. The company resulting from the merger assumes all the tax liabilities of the companies that have been merged. Registration tax (see page 164) payable on the transfer of property to the new company is reduced by 50%. Property appreciation tax is not payable on the transfer of real estate to the new company.

The law is not specific on many aspects of company reorganisations, and local advice should be obtained.

Corporate Income Tax Rates

Normal Rate. The normal rate of corporate income tax under the 1973 decree is 25%, but for the years 1974 and 1975 this was raised to 35%. There are no lower rates applicable to small profits.

Special Rates. Financial holding companies, whose functions are to hold shares in other companies and to provide them with finance or management services, are taxed at 7.5% (although for 1974 and 1975 this rate was 10.5%). For a company to qualify as a financial holding company, at least 60% of the value of its assets as shown in its balance sheet must consist of holdings of shares in other companies.

If more than 50% of the shares of a financial company are owned by the state, the rate of tax is reduced to 6.25% (1974 and 1975, 8.75%).

Financial holding companies must be registered with the Banca d'Italia, which supervises their activities.

Credit for Withholding and Other Taxes. Withholding taxes on dividends and interest are generally deductible from the total corporate income tax liability. However, if a recipient company elects for a 30% withholding tax to

be deducted from dividends from Italian resident companies, this is regarded as a final (and nonrefundable) tax and corporate income tax is not charged on these dividends.

The treatment of foreign income and the system of crediting foreign tax is described on page 131.

Returns and Assessments

The administration of corporate income tax following the 1973 reforms is detailed below. Because of the arrears of work in the tax offices, few final assessments have been issued for the years covered by the new laws and what follows is in certain respects a theoretical exposition only of the legislation as it is expected to be applied rather than a description of current practice.

Tax Year. The tax year is the calendar year. Companies are assessed on the results shown in their financial statements, whether these coincide with or end within the calendar year, and whether they are for 12 months or any other period. However, if a company prepares its financial statements covering a period of two or more years, it is assessed by calendar year.

Returns. Every company must file a return within one month of the shareholders' meeting approving the financial statements. This meeting generally takes place within four months after the company's year-end.

To be valid the return must be on a specially printed form, signed by a legal representative of the company and accompanied by:

1. The names and addresses of the directors.
2. A copy of the company's financial statements, the reports of the statutory auditors and the directors, and the resolutions approving the financial statements.
3. A schedule showing any transactions in the company's shares during the period covered by the financial statements.
4. A certificate of tax paid, issued by the tax collector, showing that tax payments have been made within the time period fixed for filing the tax return. Corporate income tax must be paid on the taxable profit shown in the return, prior to the date of its filing.

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Assessments. The tax office has five years from the end of the year in which the return should have been filed to raise assessments for additional tax. This period is increased to six years where no return has been filed.

When the assessment for additional tax becomes final, either on the taxpayer's agreement or following determination by the courts, the tax due is entered on the tax rolls of the tax office. This must be done by the end of the calendar year following that in which the assessment is finalised. The tax rolls are then delivered to the tax collector's office where tax bills are issued and served on the taxpayer. The tax bill is for any additional tax shown in the assessment and for interest on that tax. Interest is to be calculated at 6% per six months from six months after the due date for filing the tax return to the date the tax rolls are delivered to the tax collector.

Additional tax shown in the tax bill must be paid within eight days of its issue.

Appeals Procedure. An appeal against over-assessment by the tax office may be made to the Tax Commission, which consists of three levels of courts: the first and second levels and the Central Tax Commission.

An appeal to the first or second levels must be made within 60 days of receipt of an assessment or within 90 days of a refusal by the tax office to refund tax paid. If the taxpayer loses his case at the first and second levels, he may appeal to the Central Tax Commission within 60 days of the lower courts' decision. From the Central Tax Commission he may appeal to the higher civil courts.

Collection of Tax. Corporate income tax is due prior to the filing of the tax return and must be paid to the tax collector, who then issues a certificate of tax paid. Additional tax, as shown in the tax bills, is collected as described above.

Penalties. A characteristic of the 1973 reforms is the penal sanction provisions embodied in the new legislation. The law envisages a wide range of defaults, all of which are more heavily punishable than before, even to the extent of imprisonment — from six months to five years, for instance, for filing untrue financial statements, and from three months to three years for filing a false tax return or omitting to file a return at all. The object of the increased penalties is to discourage tax evasion.

The penalties for late filing of returns are now heavy fines. These range from Lit.12,500 to Lit.125,000 plus 50% to 100% of the tax due if the return is not more than one month late, and from Lit.50,000 to Lit.500,000 plus 200% to 400% of the tax due if the return is more than one month late. A

return which is more than one month late is referred to as an 'omitted' return. If a return is omitted or a false return or untrue financial statements are filed, the responsible officers of the company can be imprisoned as described on the previous page.

Penalties are also imposed where reported income is 25% or more below the income eventually assessed by the tax office, even though this was due to a deduction claim later disallowed by the tax office. These penalties, ranging from 100% to 200% of the increased tax payable, may be waived by the court if it is satisfied that the reason for the understatement of income is due to uncertainty in the tax legislation.

Where books of account are not properly kept, a penalty of from Lit.100,000 to Lit.1,000,000 may be levied, and this is doubled if tax evasion in excess of Lit.5,000,000 is proved.

Late payment of taxes shown in a tax bill results in a penalty of 2% of the outstanding tax if payment is made within three days following the due date, and 6% if payment is made after that time. This is additional to the interest on overdue tax payable as has been described.

Tax Audits. The tax office has wide powers to obtain information from a taxpayer, including the right to visit his premises and make whatever examinations it might deem necessary. In addition, the tax police are sometimes requested by a tax office to assist it in its investigations. The tax police themselves have the power to initiate an investigation into any taxpayer's affairs.

Nonresident Companies. The return, assessment, and appeal procedures for nonresident companies are the same as those for residents.

Tax Investment Incentives

The government has designated certain areas as 'assisted territories' and has granted tax and other concessions to investors in those areas. The incentives available other than tax relief are described in Chapter 2.

The Mezzogiorno. This area comprises southern Italy, Sicily, Sardinia, and various small islands. The main incentives are:

1. Profits from investments in manufacturing activities are exempt from local income tax for a period of ten years from the first year in which the activities become profitable.

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2. Newly-formed companies established to carry on manufacturing activities in the area are eligible for a 50% reduction in the corporate income tax rate for ten years from the date of formation.
3. The grants of up to 30% of fixed asset costs described on page 2-4 are tax free, provided the grant is credited to a special reserve. This reserve can only be used to cover losses; its use for any other purpose renders it taxable.
4. Any company operating in Italy may obtain exemption from local income tax of up to 70% of its profits if it can show that such profits are destined for investment in the southern area.

Central and Northern Italy. The first ten years' profits from investment in manufacturing activities by smaller and medium-sized companies in designated areas are exempt from local income tax. By 'smaller and medium-sized companies' is meant those with fixed assets after depreciation of Lit.2 billion or less, and the ten years' benefit is available from the date of constitution of the company or the expansion of a previously existing plant.

Local Income Tax

Resident and nonresident companies are subject to local income tax (*ILOR*). Taxable income for local income tax purposes is the same as for corporate income tax, except that:

1. Income from a foreign permanent establishment is excluded, but income earned abroad (not from a foreign permanent establishment) is included.
2. Dividends from shareholdings in resident and nonresident companies are excluded.
3. Income from partnerships is excluded.
4. No relief exists for losses brought forward.

The rates of local income tax are as follows:

| | Minimum % | Maximum % |
|--|------------|-------------|
| Communes | 6.0 | 8.5 |
| Provinces | 1.5 | 2.5 |
| Regions | 1.0 | 2.0 |
| Chambers of commerce | 0.4 | 1.2 |
| Spas and tourist resorts (where applicable) | — | 0.5 |
| | <u>8.9</u> | <u>14.7</u> |

In theory, therefore, rates vary from 8.9% to 14.7%, with the maximum rate in force until at least December 31, 1977, that is, 14.7% in communes which are tourist resorts and 14.2% elsewhere.

Local income tax is payable after receipt by the company of an official demand, which can be issued at any time after the filing of the tax return, and the administrative procedures followed are generally as described for corporate tax. Local income tax is not deductible for the purposes of determining taxable profits for corporate income tax.

TAXATION OF OTHER BUSINESS ENTITIES

Partnerships. Partnerships other than those limited by shares are not regarded as separate entities for tax purposes.

Once the taxable income of a partnership has been determined, it is allocated among the partners, who then pay tax on the amount allocated — personal income tax if individuals or corporation income tax if companies. For the purpose of local income tax, however, the partnership itself is a taxable entity.

The taxable income of the partnership is determined in total by applying the rules applicable to the corporate income tax. Salaries and interest on partners' capital are not subject to withholding taxes and are not deductible in determining partnership profits; they are regarded as a distribution on account of the profits of the partnership.

For the purpose of local income tax, individual partners are each entitled to an allowance of 50% of the taxable income as allocated to each partner with a maximum allowance of Lit.12,000,000 and a minimum allowance of Lit.6,000,000. Thus partners with an income from the partnership of less than Lit.6,000,000 are exempt from local income tax. The allowance is given only if it is shown that the partner's principal occupation is his partnership work.

The conditions that apply to local partners for tax purposes apply to foreign partners as well.

Partnerships must file annual returns by March 31 for the previous calendar year. The return must show the division of the profits between the individual partners and their names and addresses.

The taxation authorities have the right to issue an amended tax statement if they are not in agreement with the partnership return. If the partners do not

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accept the amended statement, the tax authorities may make a tax audit of the partnership business. The tax appeal procedures for a partnership are the same as those for a company.

Trusts. The Italian legal code does not recognise trusts and they are not relevant for tax purposes.

TAXATION OF INDIVIDUALS

Individuals resident in Italy are liable to personal income tax (*IRPEF*) on their income from all sources. They are also liable to local income tax on certain income (see page 154). Nonresident individuals are taxable only on income arising in Italy.

An individual is normally regarded as a resident if he has a home in Italy which he uses regularly, or if he lives in Italy for more than six months during the tax (calendar) year.

Until recently, the incomes of husband, wife, and dependent children were aggregated for tax purposes, and the law provided for the separate taxation of a wife's income only if her marriage had been dissolved or she was judicially separated from her husband, or where the combined income of husband and wife was less than Lit.7 million. Now, however, a wife's income is to be taxed separately.

Any income of another individual which can be freely disposed of by the taxpayer is treated as part of the taxpayer's income; this is referred to as 'attributed income.'

Taxable Income

Total income is the aggregate of income falling into the following categories:

- A — Income from real estate
- B — Income from capital
- C — Income from personal services
- D — Business income
- E — Miscellaneous income

From the aggregate of the income in all these categories, various deductions are allowed in arriving at taxable income.

Some types of income are taxable separately at special reduced rates. There are no provisions for taxing an individual on the retained profits of a closely held company.

Form of Tax Computation. Graduated tax rates are charged on taxable income, which is computed as follows:

Total income from all categories
 (excluding income subject to a final withholding tax)
plus attributed income
 = Total income
less income taxed separately
 = Aggregate income
less deductible expenses and losses
 arising from the conduct of a commercial business
 = Taxable Income

The tax due comprises:

Taxable income at graduated rates of tax
 = Gross tax payable
less credits for personal allowances
 (wife, children, and other dependants)
 = Tax payable
less credits for withholding tax
 paid on account and tax on foreign source income
 = Tax Due

Income from Real Estate. Income from this source (Category A) comprises:

Cadastral Income. Owners of real estate in Italy are presumed to derive an income from it, and unless a higher actual rent is received, a notional amount called 'cadastral income' is assumed. This is based on the value of the property as in 1939, updated by a government coefficient less certain stipulated expenses, and in theory corresponds to the market rent which could be obtained from the property. In practice, it is generally lower than the market rent. Where a building is not used by its owner and remains unlet for the entire tax year, only 20% of the cadastral income is included in the owner's taxable income.

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An owner-occupier is deemed to derive cadastral income from the occupation of his own home. Cadastral income in such a case is usually a fairly small amount.

Rental Income from Real Estate. The actual net rent from the letting of real estate located in Italy is included in the taxpayer's income if it exceeds the cadastral income.

As in the case of a corporation, in arriving at any net rent received by an individual, the tax office in practice allows a deduction of 25% from the gross rent to cover expenses if the property is residential and 33⅓% if it is commercial or industrial.

If rent from real estate is included in the profit of a business, such rent forms part of 'business income.' The amount to be included in business income is the higher of the actual net rent (rent received less allowable expenses) and the cadastral income.

The law relating to the taxation of real estate income is complex and is administered by a special section of the tax office.

Income from Capital. This income (Category B) principally includes dividends and interest.

Dividends. Dividends received by resident shareholders from Italian companies are subject to either a 10% withholding tax on account or a 50% final withholding tax. The shareholders can choose the rate to be applied; if the 10% rate is chosen, dividends will be subject to personal income tax.

Dividends on savings shares are subject to a final withholding tax of 15%.

The gross amount of dividends received by an Italian resident from foreign companies is included in his taxable income for personal income tax purposes and he is entitled to foreign tax credit. The method of calculating this credit is shown on page 132.

Interest. Interest received on bonds is subject to a final withholding tax of 10% if the bonds are issued by banks and of 20% if issued by other entities. Interest received on accounts with banks and the post office is subject to a final withholding tax of 16%. No further personal income tax is due on interest which has borne a final withholding tax and the taxpayer cannot elect to have a lower rate of withholding tax applied.

Interest not subjected to a definitive withholding tax and included in the accounts of a business is regarded as business income rather than income from capital.

Income from Personal Services. Income from personal services (Category C) is divided into two groups.

Income from Employment. Income from employment comprises all compensation and emoluments, however received, including any allowances such as for a car, living or housing expenses, or for income tax paid on the employee's behalf by his employer. Amounts received for travelling and hotel expenses in excess of Lit.18,000 per day in Italy or Lit.23,000 abroad are also included as part of employment income. These limits do not apply where the employer reimburses the employee for the actual amounts spent on business travelling.

Income from Independent Work. Independent work not only includes services performed by self-employed persons but also services performed by persons not subject to control by others; for example, directors, statutory auditors, and other professional people not carrying on a business.

An independent person who is not subject to control by others is given an allowance of 10% of his income to cover his expenses incurred in obtaining that income.

An independent person not employed in any business enterprise who has income from patents, trademarks, or the like, may claim an allowance of 30% of his income from those sources.

Business Income. The rules for the computation of personal business income (Category D) are the same as those described for companies' profits. A business loss incurred by an individual may be set against his other income in the same year, but there is no provision for any carry forward or back of losses.

Miscellaneous Income. Such income (Category E) includes gains from speculative transactions, as for instance the sale of antiques within two years of purchase, income from occasional work not regularly undertaken, income from real estate situated outside Italy, and any other income not covered by categories A through D.

Income Taxed Separately. The following income is taxed separately, unless it can be regarded as business income:

1. Receipts by employees of delayed payments of emoluments relating to prior years.

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2. Indemnities on termination of employment (for example, severance pay).
3. Capital gains realised on liquidation or transfer of a business, including the value of goodwill.
4. Compensation received for loss of goodwill.
5. Par value of shares received as stock dividends.
6. Indemnities received for termination of agency relationships.
7. Certain other indemnities received for termination of continuous and coordinated forms of collaboration.

In calculating the taxable amount of an indemnity for termination of employment, the sum received is reduced by 50% where the indemnity does not exceed Lit.10 million, by 30% where it exceeds Lit.10 million but not Lit.20 million, and by 20% where it exceeds Lit.20 million but not Lit.50 million. A further reduction is available of Lit.100,000 for each year of service, a fraction of a year counting as a complete year. Amounts received in excess of Lit.50 million do not qualify for any reduction apart from the deduction of Lit.100,000 for each year of service.

Income taxed separately is charged at the taxpayer's average rate during the two preceding tax years.

Deductions from Total Income. The following expenses incurred by the taxpayer (or by persons whose income is attributable to him) are deductible from his total income:

1. Local income tax (*ILOR*) paid.
2. Interest paid (provided that any required details are submitted to the tax office).
3. Social security and welfare contributions.
4. Life, health, and personal accident insurance premiums.
5. Medical expenses and expenses necessarily incurred in assisting persons gravely and permanently ill, in excess of 5% of total reported income up to Lit.15,000,000 and 10% of such income above Lit.15,000,000.

6. Periodic payments to a separated spouse (following a legal and effective separation or dissolution or annulment of a marriage).
7. Periodic payments to a beneficiary in terms of testamentary obligations imposed upon a donee.
8. Expenses of secondary schools and university courses, not exceeding those fixed for tuition and contributions at state institutions.
9. Funeral expenses, not exceeding Lit.500,000.

'Total income' excludes all income subject to a final withholding tax, such as interest.

Rates of Personal Tax and Reliefs

Tax Rates. Tax rates for the normal computation of personal income tax are graduated, rising from 10% on taxable income of Lit.3,000,000 or less to 72% on taxable income in excess of Lit.550,000,000, as shown in the following table:

| Taxable Income (Lit. million) | | Tax Rate |
|----------------------------------|-----|----------|
| From | To | % |
| 0 | 3 | 10 |
| 3 | 4 | 13 |
| 4 | 5 | 16 |
| 5 | 6 | 19 |
| ... | ... | ... |
| 15 | 17 | 32 |
| ... | ... | ... |
| 30 | 35 | 38 |
| ... | ... | ... |
| 50 | 60 | 44 |
| ... | ... | ... |
| 100 | 125 | 50 |
| ... | ... | ... |
| 200 | 250 | 58 |
| ... | ... | ... |
| 300 | 350 | 62 |
| ... | ... | ... |
| 400 | 450 | 66 |
| ... | ... | ... |
| 500 | 550 | 70 |
| 550 | — | 72 |

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Personal Allowances. Personal allowances are granted in the form of tax credits deductible from the gross tax payable. The current personal allowance tax credits are as follows:

- Lit.36,000 as a basic exemption.
- Lit.36,000 for the spouse.
- Lit.14,000 for one dependant, gradually escalating to Lit.306,000 for eight dependants, with an additional Lit.124,000 allowance for each dependent person thereafter.

In addition, a special allowance of Lit.84,000 is given to the taxpayer for each person's employment income included in his own taxable income.

Another allowance of Lit.18,000 is given to the taxpayer to cover the expenses indicated under the heading 'Deductions From Total Income' on page 150, but the taxpayer still has the right in his annual return to deduct from total income actual expenses incurred instead. In every case, the taxpayer may deduct local income tax paid from his total income, whether or not he takes this standard allowance in place of actual expenses.

Where the taxpayer's income includes the income of his wife, he may claim an allowance of 12% on the first million lire of his wife's income, 8% on the second million lire, and 4% on the balance, up to a maximum allowance of Lit.360,000. For the purpose of this allowance, the wife's income includes unearned income as well as earned. As already noted, the law may be changed to exclude the wife's income from that of her husband for tax purposes.

Other Tax Credits. Withholding taxes deducted at source on account of the taxpayer's ultimate liability can be credited against personal income tax payable, the taxpayer being entitled to a refund should those withholding taxes be in excess of the actual tax due.

Foreign taxes paid on income from abroad are also allowed as a credit against personal income tax payable, subject to certain limits. Where the foreign country grants a reciprocal tax credit, Italy grants a tax credit of 66⅔% of the Italian tax attributable to the foreign income. Where the foreign country does not grant reciprocal tax credit, the Italian tax credit is limited to 25% of the Italian tax attributable to the foreign income. The tax credit, which is calculated separately for each country, must be claimed in the year in which the foreign taxes are paid, otherwise it will be lost.

The calculation of the tax credit for foreign tax paid by an individual is illustrated below:

| | Income | Lit.000 Amount of Tax |
|---|---------------|--------------------------|
| Dividends from Country A (tax credit granted for Italian tax) | 1,000 | 100 |
| Dividends from Country B (no tax credit granted for Italian tax) | <u>2,000</u> | <u>600</u> |
| | 3,000 | <u>700</u> |
| Net Italian income | <u>9,000</u> | |
| | <u>12,000</u> | |
| Italian tax, e.g. | | <u>2,000</u> |
| Italian tax attributable to: | | |
| Dividends from Country A — Lit.167 | | |
| Dividends from Country B — Lit.333 | | |
| Tax Credit: | | |
| Country A: Lit.167 @ $66\frac{2}{3}\%$ = 112 | | 100 |
| (but limited to foreign tax paid) | | |
| Country B: Lit.333 @ 25% | | <u>82</u> |
| Total tax credit* | | <u>182</u> |

*The tax credit cannot exceed the foreign tax paid.

Returns and Assessments

Tax Returns. The tax year ends on December 31 and an annual tax return must be filed by the following March 31. The taxpayer must combine with his income the incomes of any other individuals which are attributable to him, and he must then submit a single tax return for the sum total.

Each calendar year, employers must give each of their employees a certificate showing gross salary paid, social security deductions, tax credits given for personal allowances, and total tax withheld. This certificate must be enclosed with the employee's annual tax return. Provided an employee has no other source of income and is not claiming any special allowances, he may sign this certificate of pay and deductions and send it to the tax office in place of the annual tax return.

Payment and Collection. Any tax shown as due in the annual tax return must be paid to the tax collector before the return is filed. A certificate of tax paid is then issued by the collector, and this must be filed with the tax return.

Any additional tax payable is assessed and collected in the same way as that for companies.

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Assessments, Appeal Procedures, Penalties, and Tax Audits. The rules for individuals are the same as those for companies.

Tax examinations are seldom made of the affairs of employees receiving wages or salaries, but the authorities have the right to audit any taxpayer's return. Tax examinations of self-employed persons' returns are occasionally made.

Nonresident Individuals

Taxable Income. Nonresidents are taxable only on income arising within Italy, which includes income derived from business activities carried on through a permanent establishment and from independent work performed in Italy. The definition of Italian source income for individuals is the same as that for companies. The liability of such income to Italian tax is modified by double taxation agreements.

Deductions. A nonresident can claim a deduction for local income tax paid and also for interest paid to an Italian resident. No personal allowances may be claimed except the personal exemption of Lit.36,000 and the special allowance of Lit.84,000 for employment income. No other deductions or allowances are available.

Returns and Assessments. A nonresident whose liability to income tax is not satisfied by withholding taxes must file a return of his Italian source income. The procedures are the same as those for resident individuals.

Temporary Foreign Workers. There are no special concessions for foreigners working in Italy for short periods of time, whether resident or nonresident.

Other Taxes on Individuals

Local Income Tax. Individuals, whether resident or nonresident, are subject to local income tax. Taxable income for local income tax purposes is the same as that for personal income tax, except that the following is excluded:

1. Income from employment. This is an important exclusion and effectively exempts the majority of Italian residents from local income tax.

2. Income from a foreign permanent establishment. (Income earned abroad, not derived from a permanent establishment, is not excluded.)
3. Dividend income (from shareholdings in resident and nonresident companies).
4. Income from partnerships. Partnerships are charged to local income tax as separate taxable entities.
5. Income subjected to a definitive withholding tax.

In computing income liable to local income tax, individual taxpayers may deduct 50% of business or farming income, and income from independent work, with a maximum deduction of Lit.12,000,000 and a minimum of Lit.6,000,000, provided the taxpayer himself works in the enterprise and that such work is his principal occupation.

Rates of local income tax vary from 8.9% to 14.7% as shown on page 144 for companies. For the years 1974 to 1977 the maximum rate applies.

Any local income tax paid by an individual is deductible in computing his income liable to personal income tax.

Wealth Tax. There is no wealth tax in Italy.

Estate Tax. Tax is levied on the total value of a deceased resident's estate, wherever situated, as accepted by the estate duty division of the tax office. The estates of nonresidents are liable only on assets situated in Italy. Estates under Lit.30,000,000 are exempt from this tax. Where an estate has borne the property appreciation tax as a result of a revaluation of real estate, that tax is deductible from the liability to estate tax. Estate tax rates are:

| Taxable Portion (Lit. million) | | Tax Rate % |
|-----------------------------------|-------|---------------|
| To | 30 | — |
| Next | 20 | 3 |
| Next | 50 | 5 |
| Next | 75 | 8 |
| Next | 75 | 11 |
| Next | 100 | 15 |
| Next | 150 | 19 |
| Next | 200 | 23 |
| Next | 300 | 27 |
| Balance over | 1,000 | 31 |

Taxation in Italy

Estate tax is not payable by the estate as such, but by each beneficiary in proportion to his inheritance.

Inheritance Tax. In addition to estate tax, beneficiaries are liable to an inheritance tax on the value of the estate, wherever situated, determined by the same rules as those for estate tax. The rate of inheritance tax depends on the relationship of the beneficiaries to the deceased. No tax is paid by linear ascendants or descendants; it is paid only by brothers and sisters, distant relatives, and others.

| Taxable Portion (Lit. million) | | Tax Rates % | | |
|-----------------------------------|-------|-------------------------|----------------------|--------|
| | | Brothers and Sisters | Distant Relatives | Others |
| To | 1 | — | — | — |
| Next | 1 | — | — | 3 |
| Next | 1.5 | — | 3 | 4 |
| Next | 1.5 | 3 | 4 | 6 |
| Next | 10 | 5 | 7 | 10 |
| Next | 15 | 8 | 11 | 15 |
| Next | 20 | 9 | 12 | 17 |
| Next | 50 | 11 | 15 | 20 |
| Next | 75 | 12 | 17 | 22 |
| Next | 75 | 14 | 19 | 24 |
| Next | 100 | 15 | 20 | 25 |
| Next | 150 | 16 | 21 | 26 |
| Next | 200 | 17 | 22 | 27 |
| Next | 300 | 18 | 23 | 28 |
| Balance over | 1,000 | 19 | 24 | 29 |

Gift Tax. All gifts to donees, wherever resident, are subject to a gift tax at the same rate as the inheritance tax. The rate therefore also depends upon the relationship of the donor to the donee, and no tax is payable where the donee is a linear ascendant or descendant.

The tax is payable by the donee, with recourse to the donor in case of default by the donee.

WITHHOLDING TAXES

Italy has a comprehensive system of withholding taxes. In general it is compulsory for the payer to withhold tax in the case of interest, dividends, royalties, payment for independent work, and wages or salaries. Only in exceptional cases, and for certain types of income such as prizes and rewards, is the withholding at the option of the paying agent.

An unusual feature of the system is that some withholding taxes are regarded as *final or definitive (a titolo d'imposta)*, i.e., the amount withheld is regarded as corresponding exactly to the tax payable by the recipient of the income. In other cases, the amount withheld by the paying agent is not considered definitive, but merely a payment on account of the taxes due (*a titolo di acconto*). In this case, the withholding tax can be credited against the recipient's final tax liability.

Another feature of the system is that the rate of withholding tax depends upon the status of the recipient, that is, whether the recipient is an individual or a company, and whether resident or nonresident. As regards deductions from nonresidents, the withholding rate may be modified by a double taxation agreement.

The following tables summarise the principal withholding taxes deductible from payments made to Italian residents and from payments made to nonresidents.

Principal Withholding Tax Rates on Payments to Residents

| | Individual | | Company | |
|---|--------------|---------|--------------|---------|
| | On Account % | Final % | On Account % | Final % |
| Compulsory Withholding | | | | |
| Interest on bonds issued by banks | — | 10 | 10 | — |
| Interest on other bonds | — | 20 | 20 | — |
| Interest from banks or post office | — | 16 | 16 | — |
| Interest from other individuals or companies | — | 15 | — | — |
| Dividends (cash, specie or bonus shares or stock dividends) | 10 | 50 | 10 | 50 |
| Dividends on savings shares | — | 15 | — | 15 |
| Royalties (20% applied to 70% of gross royalty) | 14 | — | — | — |
| Independent work | 13 | — | — | — |
| Optional Withholding | | | | |
| Prizes from authorised lotteries for charities | — | 10 | — | 10 |
| Winnings from games of chance | — | 20 | — | 20 |
| Other winnings | — | 25 | — | 25 |

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Principal Withholding Tax Rates on Payments to Nonresidents

| Country of Residence | Dividends | Interest | Royalties |
|----------------------|-----------|----------|-----------|
| Treaty Countries: | | | |
| Austria | 30(1) | Nil | Nil |
| Belgium | 15 | 15 | Nil |
| Denmark | 15 | 15(2) | 14(4) |
| Egypt | 30(1) | 15(2) | Nil |
| Finland | 15 | 15(2) | Nil |
| France | 15 | 15 | Nil |
| Germany | 30(1) | Nil | Nil |
| Greece | 25 | 10 | Nil |
| Ireland | 15 | 10 | Nil |
| Israel | 25 | 15 | Nil |
| Japan | 15(5) | 10 | Nil |
| Netherlands | 30(1)(6) | 15(7) | Nil |
| Norway | 30(1) | 15(2) | Nil |
| Spain | 30(1) | 15(2) | 14(3) |
| Sweden | 15(8) | 15(2) | Nil |
| Trinidad | 20(9) | 10 | 5 |
| United Kingdom | 15(10) | 15(2) | Nil |
| United States | 15(11) | 15(2) | Nil |
| Nontreaty Countries | 30(1) | 15(2) | 14(3) |

Notes:

1. Where the nonresident recipient is subject to income tax on dividends in his own country, such tax may be credited against the Italian withholding tax up to a maximum of 20% and a refund of Italian tax claimed.
2. 30% on bond interest.
3. The effective rate is 14% (20% true rate, but applied to only 70% of the gross royalty).
4. Tax is charged only where one company controls the other or both are under common control; control is defined as the owning of at least 40% of the share capital of the other company. The true rate is 20%, but is applied to only 70% of the gross royalty.
5. 10%, if a Japanese company controls at least 25% of the voting power in the Italian company.
6. Nil, if a Netherlands company owns at least 75% of the share capital of the Italian company.
7. 30% on bond interest. However, if the bonds carry profit-sharing rights and a Netherlands company owns at least 75% of the share capital of the Italian company, the rate is reduced to nil.
8. 10%, if a Swedish company owns at least 50% of the share capital of the Italian company.
9. 10%, if a Trinidad company owns at least 25% of the share capital of the Italian company.
10. 5%, if a UK company controls at least 51% of the voting power in the Italian company.
11. 5%, if a USA company controls at least 95% of the voting power in the Italian company and if not more than 25% of the Italian company's gross income is derived from dividends and interest (other than from subsidiaries).

DOUBLE TAXATION AGREEMENTS

Most general taxation agreements negotiated by Italy have followed the draft model convention published by the Organisation for Economic Cooperation and Development in 1963. Agreements have been concluded as follows:

1. General agreements in force —
Austria, Belgium, Denmark, Egypt, Finland, France, Germany (Federal Republic), Greece, Ireland, Israel, Japan, Netherlands, Norway, Spain, Sweden, Trinidad, United Kingdom, United States.
2. General agreement signed, but not yet in force —
Switzerland.
3. Limited agreements, concerned with shipping and air transport, in force —
Argentina, Australia, Brazil, Canada, Czechoslovakia, China, Cyprus, Dominican Republic, Ethiopia, Gabon, Ghana, Ivory Coast, Jamaica, Jordan, India, Iran, Lebanon, Madagascar, Philippines, Romania, Senegal, Sierra Leone, Singapore, Saudi Arabia, South Africa, Sudan, Switzerland, Tunisia, USSR, and Yugoslavia.

There are also some other minor agreements.

VALUE ADDED TAX

Italy adopted a value added tax (*IVA* in Italian, but referred to below as VAT) on January 1, 1973. This replaced the former turnover tax.

Taxable Transactions

VAT is chargeable on the supply of goods and services within Italy by a business or professional enterprise. Imports are also subject to VAT, and this is paid when the goods are taken through customs.

Certain supplies of goods and services are exempt from VAT; for example, renting or leasing of real estate, banking and insurance, hospitals and schools. VAT suffered on purchases by traders supplying exempted services is not recoverable. Exports are not subject to VAT, but any VAT paid by the exporter in supplying the goods or services concerned can be recovered at a later date.

Taxation in Italy

Taxable Persons

Taxable persons are all individuals or corporate bodies carrying on business or professional enterprises, including nonresident individuals and corporations providing taxable goods and services in Italy. VAT is collected from such persons, although a retailer with turnover of less than Lit.2 million per year may be exempted from VAT.

Tax Rates

VAT is chargeable at a standard rate of 14% on the net invoice price, i.e., after trade and cash discounts, but including freight and duty on imports. Examples of other VAT rates are as follows:

- Agricultural, fishery and food products, books, broadcasting, and telephone service 6%
- Food and beverages served in shops, restaurants, and hotels; textiles 9%
- Meat; automobiles of up to 2,000 c.c. 18%
- Cosmetics, cameras, record players, precious stones, and other luxury products 35%
- Automobiles of over 2,000 c.c. for private use 35%

Mechanics of VAT

Normally an invoice must be issued for each taxable transaction, showing the following information:

1. Identifying number of the invoice.
2. Names of the parties involved in the transaction.
3. Date of the transaction.
4. Nature, type, and quantity of the goods and services constituting the transaction.
5. Value of the goods or services.
6. Rate and amount of tax charged.

The retail trade is exempted from the requirement to issue tax invoices although these must be supplied to taxable persons on request.

The law requires every taxable person to keep a register of sales and purchases. These registers must contain the information given in the sales and purchase invoices respectively. The register must be numbered, officially stamped, and retained for a minimum period of five years.

Tax Returns and Payments

Monthly tax returns are normally required, although quarterly or six-monthly returns are permitted in some cases; for example, small concerns with sales not exceeding Lit.180 million may file quarterly returns instead of monthly ones.

Monthly returns must be filed within 30 days of the end of the month concerned and must show the amounts of VAT charged to customers and charged by suppliers during the month. If, as is usual, the balance shows an excess of the former over the latter, the balance must be paid over to the VAT authorities. If the balance is in favour of the trader, the amount is carried forward and is offset against amounts payable in the following period.

In addition to the monthly, quarterly, or six-monthly returns, an annual return must be filed summarising all operations for the calendar year. A supporting schedule must be attached to this annual return showing all taxable persons to whom goods have been delivered or services rendered. If at the end of the calendar year the total amount of tax charged by suppliers exceeds the total amount of tax charged to customers, the difference is either refunded or carried forward to the following year. Under the terms of a decree recently approved by Parliament, only the annual return will have to be filed in future, although the periodic payments described above will still have to be made.

Fines and Penalties

Failure to comply with all the detailed requirements laid down in the law results in fines for each and every infringement, calculated on a cumulative basis. In consequence, very large amounts are demanded by the VAT authorities from defaulting taxpayers; for example, failure to issue a tax invoice is punishable by a fine, ranging from two to four times the tax applicable to that transaction, and that offence triggers a number of other penalties. Appeal procedures are as laid down for corporate income tax.

Taxation in Italy

OTHER TAXES

Property Appreciation Tax

Liability to Tax. A property appreciation tax (*INVIM*) is payable on the increase in the value of real estate (land and buildings) realised when it is sold or otherwise transferred. The tax is payable by companies and individuals, resident or nonresident, and there is no exemption for an individual's own private residence, nor is there any form of deferment — where, for example, the proceeds of sale are reinvested in a replacement property. In addition, this tax is payable by business enterprises on unrealised increases in the value of real estate after every ten years of continual ownership, unless the property concerned is occupied by the business enterprise for its own use.

Tax is charged on the increase in value over original cost plus development expenses. An allowance of 4% of the cost of the property may be deducted from this increase for each year the property was owned. If the property was purchased before January 1, 1963, the original cost for the purpose of this tax is its value on that date. In the case of real estate companies, this base date is January 1, 1965.

In computing the tax payable, market value can be substituted for sale proceeds by the tax authorities if the sale price is understated in order to evade taxation.

Tax Rates. The tax is levied at the following rates:

| Taxable Appreciation as Percentage of Cost % | Range of Tax Rates % | Example of Actual Rate % (Milan) |
|---|---------------------------------|---|
| First 10 | 3 - 5 | 3 |
| Next 40 | 5 - 10 | 7 |
| Next 50 | 10 - 15 | 11 |
| Next 50 | 15 - 20 | 16 |
| Next 50 | 20 - 25 | 21 |
| Balance over 200 | 25 - 30 | 26 |

The range of tax rates shown is that authorised by the tax authorities. Communes have the right to select a rate within this range. Rome, Turin, and Genoa have adopted the maximum rates, while the Milan commune has chosen lower than average rates as shown above.

The calculation of the tax liability is illustrated below:

| | Lit.000 |
|---|-----------------------|
| Sale proceeds | 360,000 |
| Cost, 10 years prior to sale | <u>100,000</u> |
| | 260,000 |
| Allowance of 4% per year on cost, for 10 years | <u>40,000</u> |
| Taxable appreciation | <u><u>220,000</u></u> |

| Taxable Appreciation as Percentage of Cost (Lit.000) | | Tax Rate % (assumed) | Tax |
|---|-----------------------|-------------------------|----------------------|
| 10% of 100,000 | 10,000 | 3 | 300 |
| 40% | 40,000 | 7 | 2,800 |
| 50% | 50,000 | 11 | 5,500 |
| 50% | 50,000 | 16 | 8,000 |
| 50% | 50,000 | 21 | 10,500 |
| Balance over 200% | <u>20,000</u> | 26 | <u>5,200</u> |
| Total taxable appreciation | <u><u>220,000</u></u> | Total tax | <u><u>32,300</u></u> |

Relationship to Other Taxes. A capital gain realised by a company is regarded as ordinary business income and is subject to both corporate income tax and local income tax, although if the gain is credited to a special reserve the corporate income tax payable — but not local income tax or property appreciation tax itself — may be deferred (see page 130). The property appreciation tax is deductible from the capital gain to determine the taxable income for corporate income tax and local income tax purposes.

A capital gain realised by an individual on the transfer of real estate is not subject to personal income tax unless the property was a business asset or was bought with speculative intent. But if the capital gain is liable to personal income tax, any property appreciation tax paid is not deductible in computing personal income tax.

Property appreciation tax paid on property transferred from a deceased person's estate is deductible from the estate and inheritance taxes attributable to the property.

Property appreciation tax is not payable on a transfer of real estate between companies on a merger.

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Stamp, Registration, and Miscellaneous Taxes

Stamp Taxes. These are charged on legal documents such as the following:

1. Deeds evidencing title, which must be drawn up on special stamped paper obtainable from certain licensed shops — Lit.1,500 for each four pages.
2. Promissory notes and bills of exchange circulating in Italy — Lit.8 per Lit.1,000 of face value.
3. Evidence of payments of amounts in excess of Lit.10,000 which have not been subject to VAT — Lit.300.
4. Accounting records — Lit.1,500 for each 100 pages.

All documents which show that VAT has been paid in regard to the transaction concerned are exempt from stamp tax.

Registration Taxes. These are levied on a number of transactions including the following:

1. The transfer of real estate. Registration tax of 8% is payable on the value agreed for the property appreciation tax.
2. The issue of share capital of companies. On a contribution of cash, inventory, or other moveable property to a company in exchange for shares, registration tax of 1% is payable. The tax is levied on the issue price of the shares (nominal value plus any share premium). If real estate is contributed to a company in exchange for shares, the registration tax is 8%, except in the case of industrial buildings where the rate is reduced to 4%. These rates are all reduced by 50% on transactions resulting from a merger.

If VAT has been paid on a transaction, no registration tax is payable.

Miscellaneous Levies. A number of minor taxes are levied; the most important probably being the governmental concession tax. This tax is levied at various fixed rates, mainly in regard to licences required for certain business activities such as banking. A governmental concession tax of Lit.26,000 is payable on the registration of a new company and Lit.5,500 for each of a company's legal books.

SAN MARINO, VATICAN CITY, AND CAMPIONE

This review of taxation in Italy would not be complete without a mention of the two independent states within the Italian peninsula, San Marino and the Vatican City, and the Italian territory of Campione which is surrounded by Swiss territory.

San Marino

Situated in the Apennines some 11 kilometres (7 miles) southwest of Rimini on the Adriatic coast of Italy, San Marino is a small republic which has retained its independence since it was founded in the fourth century. It is the oldest state in Europe and takes great pride in its social legislation. Occupying an area of only 60 square kilometres (24 square miles), it has a population of approximately 20,000, most of whom are located either in the capital city of San Marino, in the new suburban region of Borgo Maggiore, or in the nearby township of Serravalle.

Tourism and agriculture are the two principal sectors of the economy, and the issue of postage stamps brings in substantial revenue. The Republic is self-sufficient in wheat, and other crops and fruits are also grown. In addition, pigs and cattle are reared, and a small amount of sulphur is mined. Most of the industrial activity is of a traditional kind, based on confectionery and ceramics, and San Marino's chief exports are wine, textiles, and building stone. Banking and transport services are adequate.

Company law is broadly similar to Italy's, except that there are no provisions for independent audit or for public filing of financial statements. A proportion of the directors must be approved by the government, and in addition at least one of the statutory auditors must be a San Marinense citizen. Every company registered in San Marino must have a resident representative there. Share capital (minimum Lit. 2 million) must be fully paid-in and a legal reserve of 20% must be maintained. Shares are normally in bearer form. Handicraft and trading companies must be managed by San Marino residents, and in general the government discourages foreign commercial companies from establishing in the Republic.

Although an independent state, San Marino is subject to Italian exchange controls as described in Chapter 2. Italian currency is used and payments between San Marino and Italy are free from any exchange controls.

Goods imported into the Republic are subject in practice to the same customs duties as in Italy. Duties normally range from 2% to 15%, depending on the type of product, but there is also an import tax of about 7%, which is fully reimbursed upon reexport.

Taxation in Italy

Companies and individuals are subject to the same graduated rates of income tax up to a basic 28%. The 28% comprises two taxes of 8% each and one of 7%, and a more recent 5% tax on pensions. The original 8% tax applies to income from capital and land, and is reduced to 6% for self-employed traders, 4% for professionals, and 2% for employees, with minor variations. The second 8% tax (called a 'complementary tax') is graduated according to the size of income, as is the more recent 7% tax; the basic rates are quickly reached, however. Both these taxes have small surcharges over the basic rates for all but the smallest incomes.

Companies operating manufacturing establishments in a designated area near Borgo Maggiore may apply for tax exemptions in connection with productive investments for periods of up to 20 years from commencement of production. The maximum tax exemption is 23%, since all enterprises must pay the 5% tax for pensions. Applications should be made to the Tax Office (*Ufficio Tributario e Giunta di Stima*), but immediate replies should not be expected. There are no double taxation treaties with other countries.

Companies pay an annual franchise tax of 0.50% of capital. Income from land is taxable at 5%. Real estate is taxed at 3% of the value of the property. Social security (health) contributions made by the employer are 22% or 23% of an employee's salary and those made by the employee, 5.9%.

There is no tax on wealth, nor are there any estate or inheritance taxes. San Marino does not have a value added tax. The government is preparing a tax reform similar to Italy's, which will radically change the taxation system.

Vatican City

The Vatican City is a tiny enclave within the Italian capital of Rome. With a population of little more than 1,000, it is a sovereign state independent of Italy. The Vatican City is under the jurisdiction of the Pope, in whom all ultimate executive, judicial, and legislative powers are vested. It serves as the world centre of the Roman Catholic Church. Only those people who are resident by reason of their employment or office are normally granted citizenship of the Vatican state. Citizenship is however accorded to all cardinals in Rome, whether or not they reside within the Vatican City limits.

The Vatican City is policed by its own army of Swiss Guards and gendarmerie and also has its own coinage, which is legal tender elsewhere in Italy.

Further trappings of independence are its own newspaper, postal system, railway station, and gas and electricity generating stations. Latin is used for official and religious occasions, but Italian serves as the everyday language.

The limited citizenship makes the Vatican City probably the world's most exclusive tax haven; it is not available to normal commercial entities. Dividends from other countries are sometimes received free from withholding taxes, by concession rather than by tax treaty.

Campione

Unlike the other two territories, Campione d'Italia is legally part of the Italian Republic. It is a detached fragment of Italian territory on the eastern shore of Lake Lugano in the Swiss canton of Ticino. Its economy depends on its casino, and there are several concessions concerning Italian taxes for resident companies and individuals. A residence permit is required, as elsewhere in Italy, but will only be issued if the applicant can prove that he has a house or a flat in the territory. While in theory a rented property is sufficient, it is practically impossible to find a property to let. This requirement and the fact that letter-box companies are not allowed physically limits the number of people who can do business in the territory.

Those who can, however, find it beautifully situated above the lake, a short drive away from Lugano in Switzerland and about 45 minutes from Milan. There are no customs barriers or border formalities with Switzerland, and visitors and residents alike can pass freely into and out of the enclave. Swiss currency, customs, and banking laws apply in Campione; telephones are connected to the Swiss system; and cars bear Ticino Canton registration plates. Italian is spoken. There is a good international school not far away at Varese, in Italy. The cost of living is much the same as in Switzerland (except that real property prices are very high) and higher than that in the rest of Italy. Swiss banks must be used, but other professional services are generally available. *SpA*'s or other Italian business entities can be freely established by Campione residents.

Neither personal income tax nor local income tax is paid by an individual Campione resident unless he trades with Italy. Companies resident in Campione pay no income taxes (again, unless they trade with Italy); instead they are liable to a payroll tax of 3,000 Swiss francs to be paid annually per employee.

Taxation in Italy

SPECIMEN TAX COMPUTATIONS — CORPORATE

| 1. Corporate Income Tax | Lit.000 |
|--|----------------|
| Profits per financial statements | 500,000 |
| Add—Bonuses paid to directors based | |
| on profits | 4,000 |
| 50% of research costs incurred | |
| during year | 6,000 |
| Maintenance costs in year in | |
| excess of 5% of depreciable assets | 3,000 |
| Doubtful debt provision in excess | |
| of 0.5% of total debtors | <u>2,000</u> |
| | 15,000 |
| | 513,000 |
| Less—Research costs of prior years now amortised | <u>1,250</u> |
| | 513,750 |
| Less—Losses brought forward from prior years | <u>30,000</u> |
| Taxable income | <u>483,750</u> |
| Corporate income tax at 25% | 120,938 |
| Less—Tax credit for foreign taxes | |
| paid in year | 8,000 |
| 'On account' withholding taxes on | |
| dividends from Italian companies | |
| (10% on Lit. 50,000,000) | <u>5,000</u> |
| Corporate income tax payable | <u>107,938</u> |
| 2. Local Income Tax | |
| Taxable income for corporate income tax purposes | 483,750 |
| Add—Losses brought forward from prior years | |
| not allowable for local income tax | <u>30,000</u> |
| | 513,750 |
| Less—Dividends from foreign companies not | |
| liable to local income tax | <u>56,000</u> |
| | 457,750 |
| Local income tax @ 14.7% | <u>67,289</u> |
| 3. Total Tax | |
| Payable at time of return— | |
| Corporate income tax as above | 107,938 |
| Already paid—'On account' withholding taxes | |
| on Italian dividends as above | 5,000 |
| Payable through tax rolls— | |
| Local income tax as above | <u>67,289</u> |
| | <u>180,227</u> |

The effective total rate of Italian tax for the year
in this example is:

$$\frac{180,227}{500,000} = \underline{\underline{36.04\%}}$$

SPECIMEN TAX COMPUTATIONS — INDIVIDUAL

1. Facts

Married taxpayer with two children aged 18 and 25, latter at university.

| Income: | Lit.000 |
|---|----------------------|
| Director's fees | 10,000 |
| Dividends from Italian companies (gross) | 500 |
| Dividends from foreign companies (gross) | 200 |
| Interest on bank deposits | 200 |
| Rents, after allowable expenses | 3,200 |
| Severance indemnity for 10 years' service | <u>7,000</u> |
| | <u>21,100</u> |

Expenses:

| | |
|--|-------|
| Medical fees | 500 |
| Interest on loan for purchase of apartment | 2,000 |
| Social security contributions | 350 |

2. Personal Income Tax

| | | |
|--|------------|---------------------|
| Director's fees | | 10,000 |
| Less—10% allowance for expenses | | <u>1,000</u> |
| | | 9,000 |
| Dividends from Italian companies (subject to 10% 'on account' withholding taxes) | | 500 |
| Dividends from foreign companies (reciprocal relief available) | | 200 |
| Interest on bank deposit (subject to 16% final withholding tax) | | — |
| Rents, after allowable expenses | | 3,200 |
| Severance indemnity (subject to separate taxation) | | <u>—</u> |
| | | 12,900 |
| Less—Medical fees (not in excess of 5% of 12,900) | | — |
| Interest on loan | 2,000 | |
| Social security contributions | 350 | |
| Local income tax (see next page) | <u>911</u> | <u>3,261</u> |
| Income subject to personal income tax | | <u>9,639</u> |

(continued)

Taxation in Italy

SPECIMEN TAX COMPUTATIONS — INDIVIDUAL (continued)

| | | Lit.000 |
|--|--|----------------|
| Tax on preceding income (Lit.9,639,000) at graduated rates | | 1,658 |
| Less—Personal allowances | | |
| Exemption | 36 | |
| Wife | 36 | |
| Two dependants | <u>29</u> | <u>101</u> |
| | | 1,557 |
| Less—Tax withheld from director's fees | 800 | |
| 'On account' withholding taxes | | |
| on Italian dividends | 50 | |
| Foreign tax withheld from | | |
| dividends (within the | | |
| 66 2/3% limitation) | <u>20</u> | <u>870</u> |
| Personal income tax payable | | <u>687</u> |
| 3. Local Income Tax | | |
| Director's fees, less allowance for expenses | | 9,000 |
| Less—Deduction (minimum) | | <u>6,000</u> |
| | | 3,000 |
| Rents, after allowable expenses | | <u>3,200</u> |
| Taxable income | | <u>6,200</u> |
| Local income tax @ 14.7% | | <u>911</u> |
| 4. Severance Indemnity | | |
| Indemnity received | | |
| Less—Deduction of 50% | | <u>3,500</u> |
| | | <u>2,500</u> |
| Average tax rate in two preceding years, e.g., 10% | | <u>250</u> |
| Payable at time of return | | |
| Personal income tax | | 687 |
| Local income tax | | 911 |
| Personal income tax on severance indemnity | | <u>250</u> |
| | | 1,848 |
| Already paid—various taxes withheld at source, | | |
| as above | | 870 |
| Final withholding tax on bank deposit interest | | <u>32</u> |
| | | <u>2,750</u> |
| The effective total rate of Italian tax for the year | | |
| in this example is: | | |
| | $\frac{2,750}{21,100} = \underline{13.03\%}$ | |

Notes

Notes

Notes

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